TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924

No. 515 7

THE UNITED STATES OF AMERICA AND FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE, PETITIONERS,

vs.

HENRY H. KAUFMAN, TRUSTEE IN BANKRUPTCY OF ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN, ET AL., ETC.

No. 516 7

THE UNITED STATES OF AMERICA AND FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE, PETITIONERS,

vs.

ALFRED C. COXE, JR., RECEIVER OF JONES AND BAKER, ALLEGED BANKRUPTS

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 5, 1924

CERTIORARI GRANTED OCTOBER 13, 1924

(30,480, 30,481)

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Case 515

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 9, 1924

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Case 516

[fol. 1] IN THE

DISTRICT COURT OF THE UNITED STATES FOR THE SECOND DISTRICT OF NEW YORK

In Bankruptcy. No. —

In the Matter of Finkelstein Bros., 87 Nassau Street, New York City, Bankrupt

Proof of Claim

Statement of Claims for Taxes Due the United States

Comes, Frank K. Bowers, Collector of Internal Revenue for the 2nd Collection District of New York, a duly authorized agent for the United States in this behalf, and says that Abraham Finkelstein, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of tax and statute involved(give section or sections): Income Tax.
Year or taxable period ended: Balance 1919.
Amount of tax: $11,533.30, together with interest at —% per mo. until paid.
Interest began Jan. 22, 1922.
#329,089, 1920 list.

[fol. 2] That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

That no security therefor is held by the United States and that there be no set-offs or counter-claims.

That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 14th day of March, 1923.

(Sgd.) Frank K. Bowers, Collector of Internal Revenue for the 2nd Collection District of New York.

Sworn to and subscribed before me this 14th day of March, 1923. Arthur I. Perry, Notary Public.

[fol. 3] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER TO SHOW CAUSE

Upon reading and filing the annexed petition of Henry H. Kaufman, Trustee in Bankruptcy in this proceeding, verified the 23rd day of February, 1923,

Let William Hayward, United States Attorney for the Southern District of New York, and Frank Bowers, Collector of Internal Revenue for the Second District of New York, show cause before the undersigned at his office No. 299 Broadway, Borough of Manhattan, City of New York, on the 14th day of March, 1923, at 12:30 o'clock in the afternoon of that day, or as soon thereafter as counsel can be heard why an order should not be granted decreeing that the claim of the Government, if any, filed with the undersigned is a claim against the individual estate of Abraham Finkelstein and as such is not entitled to payment out of the funds in the possession of Henry H. Kaufman as Trustee in Bankruptcy of Finkelstein [fol. 4] Bros., and of which bankrupt copartnership Abraham Finkelstein was a member, and further decreeing that there are no funds applicable to the claim, if any, of the United States Government as filed against the individual estate of Abraham Finkelstein, and for such other and further relief as may be just, proper and equitable in the premises.

Dated, New York, February 26th, 1923.

J. J. Townsend, Referee in Bankruptcy.

IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION OF TRUSTEE

To the Hon. John J. Townsend, referee in bankruptcy:

The petition of Henry H. Kaufman, respectfully shows and alleges [fol. 5] to this Court that he is the Trustee in Bankruptcy in this proceeding, and has duly qualified as such.

That your petitioner as Trustee has filed his final report and hearing has been duly held thereon, and said accounts are about to be passed by the Referee.

That under date of February 7th, 1923, your petitioner received a letter from the United States Attorney's Office for the Southern District of New York advising that there is due to the United States Government on account of income tax for the year 1919 the sum of $11,523.30 with interest thereon at the rate of 1% per month from January 22nd, 1922, from Abraham Finkelstein, one of the above named bankrupts, and the said letter also advises your petitioner that a proof of claim was filed against the individual estate of Abraham Finkelstein with the Referee in Bankruptcy on November 25th, 1922.

Your petitioner as Trustee in Bankruptcy in this proceeding did not receive any individual assets of Abraham Finkelstein. The assets which came into the possession of your petitioner were the assets of the copartnership of Finkelstein Bros. of which Abraham Finkelstein was one of the three members.

That before a final order of distribution is entered in this proceeding, your petitioner desires to have a decree of the Court disallowing the claim of the Government for the tax as aforesaid against the estate of Finkelstein Bros. where as a matter of fact the claim is against Abraham Finkelstein, an individual, who was one of the three members of the bankrupts herein.

Wherefore, your petitioner respectfully prays for the granting of [fol. 6] the annexed order to show cause directed against the Collector of Internal Revenue for the Second District of New York and against William Haywood, United States Attorney for the Southern District of New York, to show cause why said claim as filed should not be disallowed as a claim against the bankrupt estate of Finkelstein Bros., a copartnership herein in bankruptcy, had for such other and further relief as may be just, proper and equitable in the premises.

Henry H. Kaufman, Petitioner.

Jurat showing the foregoing was duly sworn to by Henry H. Kaufman omitted in printing.

[fol. 7] In United States District Court

Before Hon. John J. Townsend, Referee

#28384

In re Finkelstein Bros.

Hearing Before Referee on Petition and Order to Show Cause

Hearing on Order to Show Cause vs. U. S. Government—Claim

New York, March 14th, 1923, at 12:30 p. m.

Present: Robert P. Levis, 42 Broadway, by Max Sanders, for the Trustee; Victor House for the U. S. Government; Shaine & Weinrib, by Mr. Shaine for the bankrupt; Nathan Frank, for creditors.

The Trustee files the order to show cause.

The Referee: I announce that I do not find any claim on file by the Federal Government.

Mr. Sanders: I move that the Government be foreclosed from filing any claim against Finkelstein Bros.

The Referee: In view of the fact that there has been no distribution of this estate, I shall allow the Government to file any claim it has against this estate, and I will dispose of that claim when filed, according to the law and the fact.

Mr. Sanders: I ask your Honor to direct the Government to file its claim, and I reserve our right to make such motions to bar it at [fol. 8] the time the claim is taken up by your Honor for consideration.

The Referee: I will direct the Government to file this claim, with particulars, and I reserve your rights to object to the claim when filed.

Mr. House: May the matter then go over until such time as I can get all my facts together? And may I also now have noted upon the record that I am informed by the Collector of Internal Revenue for the Second District of New York that he has filed the claim in this matter against Abraham Finkelstein, one of the partners, which asserted, however, against the partnership estate as well as the Abraham Finkelstein individual estate $11,523.30, for income taxes for the year 1919, remaining unpaid, with interest thereon at the statutory rate. I understand that claim was filed November 25th, 1922, and believe that it has been mislaid or lost. I shall see that a copy of that is filed.

Mr. Sanders: I also ask your Honor to give us the right, or reserve our right, to oppose the attempt of the Government to file a claim with your Honor against Finkelstein Bros., if the claim is against Abraham Finkelstein. I want at that time to be given an opportunity to argue that motion, that your Honor refuse to accept that claim for filing.

The Referee: I think I shall let any claim be filed without prejudice to the rights of the Trustee to have it disallowed as against the partnership assets.

Adjourned to March 28th, 1923 at 3:30 p. m.

[fol. 9] Before Hon. John J. Townsend, Referee

#28384

In re Finkelstein Bros.

Order to Show Cause—Trustee vs. United States Government

New York, March 28, 1923, at 3.30 p. m.

Present: Robert P. Levis, Esq., Attorney for Trustee, by Max E. Sanders, Esq.; Victor House, Esq., Assistant United States Attorney;

William M. A. O'Neill, Esq., Special Assistant United States Attorney.

The Referee has before him the following:

Proof of claim filed by the Collector of Internal Revenue with the Referee on March 15th, 1923, in the sum of $11,523.30 exclusive of interest, against Finkelstein Brothers of 87 Nassau Street.

Also claim filed the same date in the sum of $11,523.30 exclusive of interest, against Abraham Finkelstein.

Mr. Sanders: I have noticed from the claim that has been filed with the Referee on the 13th of March, 1923, that the address of the Finkelstein Brothers referred to in the claim is located at 87 Nassau Street.

The records of the Referee show that the Finkelstein Brothers who [fol. 10] are in bankruptcy in this proceeding had their place of business at 3 West 19th Street, Borough of Manhattan, New York City, during the years 1919-1920.

I therefore ask that the matter be adjourned so as to give Mr. House and myself an opportunity to find out whether the claim is properly against the taxee in this proceeding, and that adjournment to be without prejudice to any rights I may have to move to strike this claim from the records.

The Referee adjourned the hearing to Tuesday, April 3rd, 1923, at 3:30 P. M.

Before Hon. John J. Townsend, Referee

#28384

In re Finkelstein Brothers

Hearing on Order to Show Cause—Trustee vs. United States Government

New York, April 3rd, 1923, at 3.30 p. m.

Appearances: Mr. Crawford, representing United States Attorney.

By consent hearing adjourned to Wednesday, April 10th, 1923, at 3 P. M.

[fol. 11] Before Hon. John J. Townsend, Referee

#28384

In re Finkelstein Bros.

Adjourned Hearing on Claim of United States Government

New York, April 10th, 1923, at 3 p. m.

Present: Max E. Sanders, Attorney for Trustee, by Max Sisenwein, Esq.; Mr. O'Neill, Special Assistant United States Attorney.

By consent hearing adjourned to Wednesday, April 18th, 1923, at 3 P. M.

Before Hon. John J. Townsend, Referee

#28384

In re FINKELSTEIN BROTHERS

Adjourned Hearing on Order to Show Cause—Trustee vs. United States Government

New York, April 18th, 1923, at 3 p. m.

Present: Robert P. Levis, Esq., Attorney for Trustee, by Max E. [fol. 12] Sanders, Esq.; William M. A. O'Neill, Esq., Special Assistant United States Attorney; I. Michaelsohn, Esq., a creditor.
Mr. O'Neill addressed the Referee.
Mr. Sanders addressed the Referee.

The Referee: As I understand it, the Government are claiming. and they are moving to be paid out of the partnership ahead of the unsecured creditors.
Mr. Sanders: That is the point.
Mr. O'Neill: And upon that question we ask leave to submit a memorandum at the date you specify or upon the adjourned date. setting out what our contention is, that our contention is correct, that the Government has the right to be paid out of the assets of the copartnership.
The Referee: Ahead of the unsecured creditors?
Mr. O'Neill: Yes, sir. If it is agreeable to you we will make an adjourned date, and I will submit a memorandum.
The Referee: You ascertain the tax under the Statute against John Jones. If John Jones has nothing in the funds, you have either got to take one case or another; you have either got to say that the partnership is liable for John Jones ahead of the creditors.
Or else you have got to say that there are facts in connection with the partnership estate which show that it gives you the right to call upon it to pay John Jones' taxes on this date.
[fol. 13] Unless you take either horn of the dilemma and say any tax against John Jones comes ahead of the creditors of the partnership estate——
Mr. O'Neill: That is what we do assert.
Mr. Sanders: That is all we have got to do; set up proof that Mr. Kaufman did not receive any moneys belonging to his individual estate, and as far as we are concerned, rest our case.

Adjourned to Thursday, April 26th, 1923, at 4 p. m.

Before Hon. John J. Townsend, Referee

#28384

In re ABRAHAM FINKELSTEIN, ISREAL FINKELSTEIN, and NETTIE FINKELSTEIN, Individually and as Co-partners, Trading as Finkelstein Brothers

Adjourned Hearing on Order to Show Cause—Trustee vs. United States Government (Claim for Income Tax)

New York, April 26th, 1923, at 4 p. m.

Present: Henry H. Kaufman, Esq., Trustee, in person, Robert P. Levis, Esq., attorney for Trustee, by Max E. Sanders, Esq.; William [fol. 14] H. Hayward, Esq., United States Attorney for the Southern District of New York, and for the Collector of Internal Revenue of the Second District of New York, represented by William M. A. O'Neill, Esq., Assistant United States Attorney, of Counsel; Nathan Frank, Esq., Attorney for I. Michaelson & Son, a creditor.

Mr. O'Neill: The Government's contention is that the Government's claims against the individual members of this partnership are payable out of the partnership estate prior to the payment of the general co-partnership creditors, and the priority confirmed by Section 3466 of the Revised Statutes attaches to the partnership funds as well as to the individual assets of the co-partnership.

Mr. Sanders: As I understand it, Mr. O'Neill, your claim here is that Arbaham Finkelstein owes you how much?

Mr. O'Neill: The amount of the claim of $11,523.30.

Mr. Sanders: As I understand it, Mr. O'Neill, your contention is that there is due the Government approximately $11,000 from the estate of Abraham Finkelstein?

Mr. O'Neill: It is stated that the Government has filed claim in the sum of $11,523.30 against one Abraham Finkelstein, member of the co-partnership of Abraham Finkelstein, Isreal Finkelstein, and Nettie Finkelstein, individually, and as co-partners, trading as Finkelstein Brothers.

[fol. 15] HENRY H. KAUFMAN, being first duly sworn by Richard O. Smith, Notary Public in the office of the Referee, testified as follows:

Examined by Mr. Sanders:

Q. What is your address, please, Mr. Kaufman?

A. My business address is 115 Broadway.

Q. Were you appointed Receiver in Bankruptcy in this proceeding?

A. I was.

Q. Do you remember when that was?

A. November 20th, 1920.

Q. Did you qualify as Receiver?

A. I did.

Q. Did you file your accounts in this Court as Receiver?

A. I have.

Q. As Receiver in this proceeding did you receive any funds for the individual estate of Abraham Finkelstein?

A. None.

Q. All the assets that came into your possession, were they assets of the co-partnership, or of the individuals composing that firm?

A. The assets which came into my possession were assets which I was told were assets of the firm, and they represented merchandise, laces and embroideries which I found in the place of business of Finkelstein Brothers, and also moneys collected on outstanding accounts appearing on the books of Finkelstein Brothers which I found in their place of business. I received no assets from any source whatsoever which belonged to Abraham Finkelstein individually.

Q. Were your accounts as Receiver passed upon by the Court?

A. They were.

Q. Were you subsequently discharged as Receiver?

A. I was.

Q. Did you turn over your funds as Receiver to yourself as Trus-[fol. 16] tee?

A. I did, with the exception of one fund, which I was directed to keep in a special account.

Q. That was subject to reclamation?

A. Yes, sir. I have since disbursed, pursuant to the order of the Court, that money, but that money was also moneys that was realized from the sale of assets of the firm of Finkelstein Brothers.

Q. Now, since then you were elected Trustee, at the first meeting of creditors?

A. I was.

Q. You qualified as Trustee?

A. I did.

Q. And the moneys that you had collected as Receiver were turned over to yourself as Trustee?

A. Correct.

Q. Did you during your Trusteeship collect any funds belonging to the individual estate of Abraham Finkelstein?

A. I did not.

Q. And the moneys you now have on hand are the proceeds of sale of the assets at public auction during the Receivership, and the collection of outstanding accounts that were turned over to yourself as Trustee by yourself as Receiver?

A. Correct.

Q. Was the final account as Trustee filed in this Court?

A. Yes, sir.

Q. And your Receiver's accounts were filed in this Court?

A. Yes, sir.

Mr. Sanders: I offer the Trustee's account and the Receiver's account in evidence.

Examined by Mr. O'Neill:

Q. Mr. Kaufman, when you took charge did you go over these accounts yourself?

[fol. 17] A. No, personally I did not go through the books myself. My representative, Mr. Frederick H. Nicholls went through the books, in conjunction with Miss Nettie Finkelstein and made up a list for me of the outstanding accounts due Finkelstein Brothers as shown by their books; and after such list was prepared I went over them, personally, with them.

Q. You stated that you employed Mr. Nicholls, Mr. Frederick H. Nicholls, an accountant?

A. No; he was my representative at the place of business. He was not an accountant, but he understood books.

Q. He is not an accountant?

A. No.

Q. Is it customary for the Trustee to accept the report of one who is not an accountant?

A. Certainly.

Q. It is the custom?

A. The point I make in answer to your question is, I can do it myself, go through the books and ascertain what the receivables are, if I wanted to take up the time; but in order to avoid the necessity of doing that, I had Mr. Nicholls do it. He is fully competent to do it, because he has done it in hundred of cases and understands books thoroughly. He is not an accountant, nor is he generally employed as a bookkeeper.

Q. Am I to understand that you accepted the report of the condition of the books of Mr. Fred Nicholls, who you state is not an accountant?

A. No.

Q. Did anyone assist Mr. Nicholls in the examination of the books?

A. He availed himself of the services of Miss Netti Finkelstein, who was formerly the bookkeeper of Finkelstein Brothers and was familiar with all their affairs.

Q. Is this Miss Netti Finkelstein a member of that co-partnership?

A. Yes, sir.

[fol. 18] Q. Did you examine the condition of Abraham Finkelstein at this time?

A. I did.

Q. What did he inform you as to his financial condition at this time?

A. He stated to me that all the property that he had in the world had been placed by him in the firm of Finkelstein Brothers; that he had no individual assets.

Q. Did you examine him in any proceeding to ascertain whether his statement was true, that he had no assets at that time?

A. I did not, but my attorneys did.

Q. And do you know the result that they found?

A. I understand that they found no individual assets belonging to Mr. Abraham Finkelstein.

Q. Are you prepared to swear that you are satisfied that Abraham Finkelstein has no assets?

A. At the present time? That I cannot tell.

Mr. Sanders: I object to the form of the question.

Q. Are you prepared to swear that Abraham Finkelstein had no assets at the time you examined him?

A. I am prepared to swear that from the investigations that I made, that it appeared that Mr. Finkelstein was telling me the truth when he said he had no assets other than his interest in the firm of Finkelstein Brothers.

Q. Did anybody else inform you that Abraham Finkelstein at this time had no assets, so far as it was found?

A. My attorneys reported to me that from the investigation that they had made, and the examinations, that they found no individual assets of Abraham Finkelstein, and as I recall it, in the [fol. 19] schedules that he filed, which were sworn to by him, he did not schedule any individual assets.

Q. Mr. Kaufman, are you acquainted with the division of the profits as it existed in this firm?

A. I may have known it at the time, but I do not recall it at this late date.

Q. Do you know of your own belief whether or not Abraham Finkelstein had any assets due and owing him in the partnership?

A. The only thing I can say in answer to this question is to say that he had nothing due him until the creditors had been paid in full.

Q. Do you know what his interest was in this partnership?

A. You mean his percentage?

Q. His percentage.

A. I don't recall what it was. He had a very substantial interest.

Q. Up and above the amount due to the creditors, do you recall at this time if there are any assets in favor of Abraham Finkelstein?

A. No, there were not.

Q. Then I am to understand that at no time did you employ any certified accountant upon these books?

A. I did employ a certified accountant on these books at a date subsequent to the time that I had Mr. Nicholls make up for me a tentative statement of the outstandings, and I then employed, as I recall it, Samuel D. Leidesdorf & Company.

Mr. O'Neill: I renew the Government's contention that the Government's claim is against the individual Abraham Finkelstein, member of the co-partnership of Abraham Finkelstein, Israel Finkelstein, and Netti Finkelstein, individually, and as co-partners, trad- [fol. 20] ing as Finkelstein Brothers, and that the claim is payable out of the partnership estate prior to the payment of all gen-

eral co-partnership creditors, and the priority confirmed by Section 3466 of the Revised Statute attaches to the partnership fund as well as to the individual assets of the co-partnership.

Q. How much money is there in the estate of this bankrupt firm?

A. There is some cash, but the exact amount I don't recall; but it appears in my final account as Trustee. Of course, since my accounting has been filed there is a certain amount for interest on the moneys deposited on which I will file a supplementary report The amount of interest is very small.

Q. Can you recall the approximate amount, the exact or approximate amount?

A. I don't remember, but it my recollection serves me, it is about $14,000.

Q. Have you at any time paid a divident in this estate?

A. There has been a divident of 15% already paid to creditors prior to the filing of the Government's claim, or prior to the time that I had knowledge that the Government intended to serve a claim.

Mr. Sanders: I offer in evidence the schedules filed by Abraham Finkelstein with the Clerk of the United States District Court for the Southern District of New York, and referred to the Hon. John J. Townsend as Referee.

At this time I renew my motion to dismiss the claim filed by the Government on the following grounds:

[fol. 21] First. That the said claim was filed after the year within which claims could be filed had expired and

Second. On the ground that there is no estate, no individual estate of Abraham Finkelstein, and therefore the claim of the Government cannot lie, and

On the further ground that the claim of the Government, if any claim at all, would be against the individual estate of Abraham Finkelstein or any assets received by the Receiver or Trustee in this proceeding from the individual estate of Abraham Finkelstein, and that from the testimony of the Receiver and Trustee of this estate, it would appear conclusively that no assets of the individual estate of Abraham Finkelstein came into his possession; but on the other hand, that the assets that came into his possession were assets of the co-partnership of Finkelstein Brothers.

Mr. O'Neill: I object to that motion, because if there were any strength to be given the same, it would be waived by the appearance here of the bankrupt herein, and further that the Government may file its claim at any time before final distribution of the estate.

Mr. Sanders: I would like to have it noted on the record that Mr. Abraham Finkelstein appears here voluntarily, and that if the Government desires to use him as a witness on any point which they

raised before the Referee, he is ready and willing to testify, and I have no objection.

[fol. 22] The Government will file briefs within ten days and Mr. Sanders will file a reply in brief within seven days thereafter.

—— ——.

Subscribed and sworn to before me this — day of ——, 1923.
—— ——, Referee.

Closed.

In United States District Court

[Title omitted]

Stipulation

It is hereby stipulated between the attorneys for Frank K. Bowers, [fol. 23] Collector of Internal Revenue for the Second District of New York, the claimant above-named, and for the trustee of the above-named bankrupts, that the total income of the bankrupt Abraham Finkelstein, upon which the tax claimed herein was based, was derived from the business of the co-partnership Finkelstein Brothers; and it is

Further stipulated that the foregoing stipulation may be taken as and in lieu of testimony herein and shall be regarded as part of the record; and it is

Further stipulated that the report of Referee John J. Townsend herein dated June 11, 1923, be deemed the Referee's certificate herein on petition to review his order herein relating to said claim and the payment thereof out of the assets of the partnership Finkelstein Brothers in advance of the payment of general partnership creditors.

Dated, New York, August 20th, 1923.

Robert P. Levis, Attorney for Trustee. Wm. Hayward, United States Attorney for the Southern District of New York, Attorney for Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

[fol. 24] In United States District Court

[Title omitted]

Opinion and Report of Referee

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

I, John J. Townsend, Referee in Bankruptcy, have before me a motion arising under an order to show cause, dated February 26,

1923, made by the Referee on the Petition of the Trustee in Bankruptcy, requiring the Collector of Internal Revenue to show cause why an order should not be made decreeing that the above claim is a claim against the individual estate of Abraham Finkelstein and is not to be paid out of the partnership assets in which the individual estate of Abraham Finkelstein has no interest or equity within subdv. f of Section 5 of the Bankruptcy Act.

[fol. 25] Such petition and order to show cause was filed with the Referee March 14, 1923, and accompanies this report.

Accompanying this report are also the stenographer's minutes of the proceedings before the Referee consisting of 20 pages.

The Collector's claim has been filed in duplicate and accompanies this report.

The proof of claim should be read as a whole.

In terms it asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.

The question of priority and of rate of interest will be reserved by the Referee for the present.

The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourths aggregating $11,523.30 form the basis of the present claim.

On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.

It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 18, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interest in the partnership at that time.

[fol. 26] At the hearing it appeared (S. M., pages 13, 18) that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property of Abraham Finkelstein. It was conceded (S. M., page 17) Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is however conceded that in this there is no surplus.

At the hearing (S. M., page 12) the Government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general copartnership creditors.

At the hearing (S. M., page 19) the Trustee contended that the Government's claim was only payable out of any individual assets (of which in this case there were none) belonging to the individual estate of Abraham Finkelstein within subdv. f of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

"That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *"

[fol. 27] It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly imposed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

"Sec. 218 (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed."

"Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the [fol. 28] names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled "Part II—individuals."

In my opinion the Sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.: Section 218 (a) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdv. f of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkelstein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the Statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

I find nothing in the Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the *res* which the Collector may seize. Those three sections read as follows:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon [fol. 29] all property and rights to property belonging to such person; * * *.

"Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

"Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid."

Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as [fol. 30] an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets,

which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finkelstein as an individual under Section 218 (a) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above (S. M., page 4).

Congress having deliberately chosen the plan of taxation indicated in those sections, instead of assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Collector is precluded from asserting the different rule here contended for by him, even if (as he points out) the statutory plan works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner "in his individual capacity."

I read the following cases as supporting the views expressed in this memorandum:

U. S. vs. Hack, 8 Peters, 271;
U. S. vs. Evans, Crabbe, 60; 2 Fed. Cases, #15062.

[fol. 31] The Collector relies on the following cases:

In re Straussberger, 4 Woods, 557; 23 Fed. Cases, #13526.
Lewis vs. U. S., 92 U. S., 618.

In the Straussberger cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claim of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning "When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc."

I cannot read the Lewis case as impairing the prior decision of the U. S. Supreme Court in U. S. vs. Hack. The facts were as follows:

The United States had a claim against the partnership of Jay Cook McCulloch & Co. of London hereafter called the English firm.

The English firm was composed of seven American partners and three English partners.

Jay Cook & Co. of Philadelphia hereafter called the American firm was composed of the seven American partners of the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a [fol. 32] claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States (S. M., page 620).

The Supreme Court merely decided that the United States holding

a claim primariy against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector—that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors—which is the proposition condemned in U. S. vs. Hack, supra.

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Revenue against the partnership assets of Finkelstein Brothers in priority to the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy.

Dated, New York, June 11, 1923.

J. J. Townsend, Referee in Bankruptcy.

[fol. 33] In United States District Court

[Title omitted]

Motion to Confirm Report

Sirs: Please take notice that a motion will be made at a Stated Term of this Court to be held in the Post Office Building, Borough of Manhattan, City of New York, on the 20th day of June, 1923, at 10:30 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard for an order confirming the report of Hon. John J. Townsend, Referee in Bankruptcy, dated June 11, 1923, and filed with this Court, and for such other and further relief as may be just, proper and equitable in the premises.

Dated, New York, June 14, 1923.

Robert P. Levis, Attorney for Trustee.

Office and Post Office Address, 42 Broadway, Borough of Manhattan, City of New York.

To William Hayward, United States District Attorney, Attorney for U. S. Government, Post Office Building, Manhattan.

[fol. 34] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OF REFEREE

Upon the proof of claim heretofore filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, on behalf of the United States of America, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30 with interest from January 22, 1922, to date of payment, against Abraham Finkelstein individually and against the [fol. 35] co-partnership of Finkelstein Brothers; the petition of Henry H. Kaufman, the trustee herein, verified February 23, 1923, and the order to show cause issued thereon by Referee John J. Townsend on February 26, 1923; and hearings and due deliberation having been had thereon, and the opinion of the Referee having been heretofore duly filed herein, it is, on motion of Robert P. Levis, Esq., attorney for the Trustee,

Ordered that the claim filed herein as aforesaid by Frank K. Bowers as Collector of Internal Revenue for the Second Collection District of New York be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein coming into the hands of the trustee herein, and it is further

Ordered that the trustee herein apply the assets of said co-partnership of Finkelstein Brothers coming into his hands toward the payment of said claim only after the payment in full of the claims of all creditors of said copartnership of Finkelstein Brothers.

J. J. Townsend, Referee.

[fol. 36] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION TO REVIEW

To John J. Townsend, Esq., referee in bankruptcy:

The petition of Victor House, Assistant United States Attorney for the Southern District of New York, respectfully alleges:

That Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, is the creditor of Abraham Finkelstein, one of the above named bankrupts, for balance of income tax for the year 1919 in the sum of $11,523.30, and claims to be entitled to payment of said claim out of the partnership assets of Finkelstein Brothers prior to the payment of general co-partnership creditors; that the claim of the said Frank K. Bowers as such Collector has been duly filed herein; that on the 24th day of August, [fols. 37 & 38] 1923, an order of which a copy is hereto annexed was duly made and entered herein postponing payment of said claim

until after the payment of partnership creditors of the above named partnership in full.

That such order is erroneous in that the same is contrary to the evidence, the weight of the evidence and contrary to law.

Wherefore, your petitioner respectfully asks that the said order may be reviewed as provided in the bankruptcy law of 1898 and general order XXVII.

Dated, New York, August 29, 1923.

Victor House, Petitioner.

Jurat showing the foregoing was duly sworn to by Victor House omitted in printing.

[fol. 39] In United States District Court

[Title omitted]

Referee's Certificate

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

I, John J. Townsend, Referee in charge of this case, do hereby certify that in the course of the proceedings had before me herein, the following question arose pertinent to the proceedings:

On March 15, 1923, the Collector of Internal Revenue filed with me a proof of claim, asserting a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, amounting to $11,523.30. Priority in payment before all claims, together with interest at one per cent. per annum until paid, beginning January [fol. 40] 22, 1922, was also asserted.

The Trustee, on his petition, obtained an order to show cause dated February 26, 1923, requiring the Collector of Internal Revenue to show cause why an order should not be made decreeing that the above claim is a claim against the individual estate of Abraham Finkelstein and is not to be paid out of the partnership assets in which the individual estate of Abraham Finkelstein has no interest or equity within subd. (f) of §5 of the Bankruptcy Act.

Proceedings were thereupon had before me, as shown by the accompanying stenographer's minutes, consisting of 20 pages.

There is also to be considered as part of the evidence the stipulation filed with me August 24, 1923, to the effect that the income of the bankrupt Abraham Finkelstein upon which the tax claim herein was based, was derived from the business of the co-partnership of Finkelstein Brothers.

After due consideration, I made a Report to this Court, dated June 11, 1923, and on August 24, 1923, I filed an order to the effect that the claim aforesaid be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein coming into the hands

of the Trustee, and that the Trustee apply the assets of the bankrupt copartnership of Finkelstein Brothers coming into his hands toward the payment of said claim only after the payment in full of the claims of all creditors of said copartnership of Finkelstein Brothers.

On August 30, 1923, the Collector of Internal Revenue feeling aggrieved at my order of August 24, 1923, filed with me his petition for review, which was granted.

[fol. 41] The question presented on this review is whether the Referee was correct in deciding that the claim filed for Income Tax for the year 1919 of Abraham Finkelstein should be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein, and that the Trustee apply the assets of the copartnership of Finkelstein Brothers coming into his hands toward the payment of said claim only after the payment in full of the claims of all creditors of said copartnership of Finkelstein Brothers.

I hand up herewith for the information of the Judges, the following papers:

(1) Proof of claim, filed March 15, 1923, at $11,523.30.
(2) Order to show cause and Petition of Trustee, filed March 14, 1923.
(3) Stenographer's minutes, pages 1-20.
(4) Report of Referee on above claim, filed June 12, 1923.

N. B.—The papers (1) to (4), inclusive, are attached to the Referee's Report, filed June 12, 1923, in the office of the Clerk.

(5) Stipulation, filed August 24, 1923.
(6) Order on claim, filed August 24, 1923.
(7) Petition for review, filed August 30, 1923.

New York, October 2, 1923.

J. J. Townsend, Referree in Bankruptcy.

[fol. 42] **In United States District Court**

[Title omitted]

Notice of Motion to Set Aside Referee's Order

Sir: Please take notice that upon the proceedings heretofore had herein, the undersigned will move this Court at a term thereof for motions to be held in Room 235 of the United States Courts and Post Office Building at Broadway and Park Row in the Borough of Manhattan, City and Southern District of New York, on the 5th day of September, 1923, at 10:30 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, for an order vacating and setting aside the order of Referee John J. Townsend herein dated August 24th, 1923, postponing the payment of the claim filed by Frank K. Bowers, Collector of Internal Revenue for the Second Dis-
[fol. 43] trict of New York, on behalf of the United States of

America, against Abraham Finkelstein, one of the above named bankrupts, out of the partnership assets coming into the hands of the trustee herein until after the payment of partnership creditors in full, and for an order directing the payment of said claim out of said partnership assets prior to the payment of co-partnership creditors, and for such other and further relief as may be proper.

Dated, New York, August 29, 1923.

Yours, etc., William Hayward, United States Attorney for the Southern District of New York, Attorney for Frank K. Bowers, Collector of Internal Revenue, etc.

To Robert P. Levis, Esq., Attorney for Trustee, 42 Broadway, New York City.

[fol. 44] In United States District Court

[Title omitted]

Judgment—Filed Oct. 22, 1923

This matter having come on to be heard, and after hearing Victor House, Esq., of counsel for Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, in support of a motion to reverse the order of Referee John J. Townsend dated August 24, 1923, and Max E. Sanders, of counsel for Henry H. Kaufman, Trustee in Bankruptcy, in opposition thereto, it is

Ordered that the order of John J. Townsend, Esq., Referee in Bankruptcy in this proceeding, dated August 24, 1923, be and it hereby is in all respects affirmed.

Learned Hand, U. S. D. J.

[fol. 45] In United States District Court

[Title omitted]

Petition for and Order Allowing Appeal

To the Honorable the Judges of the United States District Court for the Southern District of New York:

The United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, feeling aggrieved by the order and decree of the United States District Court for the Southern District of New York, made by the Honorable Learned Hand, one of the Judges thereof, and entered herein on the 22nd day of October, 1923, in the above entitled proceeding, affirming an order of John J. Townsend, Esq., Referee in

Bankruptcy, dated August 2, 1923, allowing the claim filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second [fol. 46] District of New York on behalf of the United States, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30 with interest from January 22, 1922, to date of payment, as a claim against the individual assets of the bankrupt Abraham Finkelstein, but directing that the trustee apply the assets of the co-partnership of Finkelstein Brothers, coming into his hands, toward the payment of said claim, only after the payment in full of the claims of all creditors of the said copartnership of Finkelstein Brothers, instead of directing the payment of said claim out of the assets of said copartnership prior to the payment of co-partnership creditors, do hereby petition for an appeal upon the said order and decree, to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Dated, New York, October 24, 1923.

United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, by William Hayward, United States Attorney for the Southern District of New York.

The foregoing appeal is hereby allowed.

L. Hand, U. S. D. J.

[fol. 47] IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF APPEAL

SIRS: Please take notice that the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, hereby appeal from the order and decree of the United States District Court for the Southern District of New York, made by Honorable Learned Hand, one of the Judges hereof, and entered herein on the 22nd day of October, 1923, affirming an order of John J. Townsend, Esq., Referee in Bankruptcy, dated August 24, 1923, whereby the claim filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, on behalf of the United States of America, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30, with interest from January 22, 1922, to date of payment, against Abra- [fol. 48] ham Finkelstein, individually and against the co-partnership of Finkelstein Brothers, was allowed as a claim against the in-

dividual assets of the bankrupt Abraham Finkelstein, but not allowed as a claim against the copartnership of Finkelstein Brothers, until after the payment of the claims of all the creditors of the said co-partnership in full, to the Circuit Court of Appeals for the Second Circuit, to be held in and for the said Circuit at the United States Courts and Post Office Building, in the Borough of Manhattan, City of New York.

Dated, New York, October 23, 1923.

Yours, etc., William Hayward, United States Atorney for the Southern District of New York, Attorney for United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York.

Office and P. O. Address, U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

To Robert P. Levis, Esq., Attorney for Trustee, 42 Broadway, New York City; Alexander Gilchrist, Jr., Esq., Clerk of the District Court of the United States for the Southern District of New York.

[fol. 49] In United States District Court

[Title omitted]

Assignment of Errors

Now come the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York and file the following assignment of errors:

1. That the United States District Court for the Southern District of New York erred in affirming the order herein of John J. Townsend, Esq., Referee in Bankruptcy, dated August 24, 1923.

[fol. 50] 2. That the said Court in its order dated October 22, 1923, affirming the order of said John J. Townsend, Esq., Referee in Bankruptcy, dated August 24, 1923, erred in failing to allow the claim filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, on behalf of the United States of America, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30 with interest from January 22, 1922, to date of payment, as a priority claim to be paid out of the assets of the co-partnership of Finkelstein Brothers coming into the hands of the trustee herein, prior to the payment of the claims of general copartnership creditors.

Wherefore, the United States of America prays that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and

for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein allowing said claim of the United States of America as filed, as a priority claim against the copartnership assets of Finkelstein Brothers coming into the hands of the trustee herein, in advance of the payment of dividends to general copartnership creditors.

Dated, New York, October 24, 1923.

William Hayward, United States Attorney for the Southern District of New York.

[fol. 51] CITATION—In usual form; omitted in printing

[fol. 52] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE TRANSCRIPT OF RECORD

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the U. S. District Court for the Southern District of New York, in the above-entitled matter, as agreed upon by the parties.

Dated, New York, December 19, 1923.

Robert P. Levis, Attorney for Henry H. Kaufman, Trustee.
Wm. Hayward, United States Attorney for the Southern District of New York, Attorney for United States of America and Frank K. Bowers, Collector.

[fol. 53] IN UNITED STATES DISTRICT COURT

[Title omitted]

CLERK'S CERTIFICATE

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this 21st day of December, in the year of our Lord one thousand nine hundred and twenty-three and of the Independence of the said United States the one hundred and forty-eighth.

Alex. Gilchrist, Jr., Clerk.

38854.

[fol. 54] In United States Circuit Court of Appeals for the Second Circuit, October Term, 1923

Nos. 267-338

Argued March 17, 1924. Decided April 7, 1924

In the Matter of Abraham Finkelstein, Israel Finkelstein, and Nettie Finkelstein, Individually and as Copartners, Trading as Finkelstein Bros., Bankrupts

Re Claim of Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, for $11,523.30

United States of America and Frank K. Bowers, as Collector of Internal Revenue for the Second District of New York, Appellant,

v.

Henry H. Kaufman, Trustee in Bankruptcy, Appellee

In the Matter of Jones & Baker, Alleged Bankrupts

Appeal from the District Court of the United States for the Southern District of New York

Before Rogers, Hough, and Mayer, Circuit Judges

Opinion

These two appeals were argued at the same time and will be disposed of in one opinion.

In the Finkelstein case the District Court for the Southern Dis- [fol. 55] trict of New York affirmed the order of the Referee in bankruptcy allowing the claim of Bowers, Collector against the individual assets of Finkelstein, but not against the partnership assets. The facts are sufficiently set forth in the opinion of Referee Townsend which, because of its careful review of the question litigated, we quote infra.

In the Jones & Baker case, the District Court for the Southern District of New York reached the same conclusion on a different

state of facts, in respect of which, however, there is no difference in principle from what was held in the Finkelstein case.

The facts in the Jones & Baker case may be briefly stated.

Jones & Baker was a partnership composed of two partners, William R. Jones and Jackson B. Sell, and was engaged in the stock brokerage business. On March 31, 1923, an involuntary bankruptcy proceeding was commenced against the firm in the District Court for the Southern District of New York and a receiver was appointed.

An offer of composition in bankruptcy was made by the firm to the partnership customers and creditors, as distinguished from the creditors of the individual partners, which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. No offer of composition was made to the creditors of the individual partners. This offer of composition was confirmed by the District Court, and the Receiver was directed to carry it into effect. Under the composition the creditors of the firm cannot by any possibility recover the full amount of their claims.

In July, 1923, more than one month after the appointment of the receiver, the government, upon a re-examination of the individual tax returns of the individual partners, for the years 1918, 1919 and 1920, assessed certain additional income taxes against [fol. 56] Jones for $632,768.04 and Sells for $62,661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts.

As the result of negotiations, a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned.

The Government, however, has endeavored in the bankruptcy proceeding to assert these claims as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the use and benefit of the creditors of the firm and has endeavored to enforce the two claims as being entitled to payment out of the firm's assets prior to the customers and creditors of the firm.

The opinion of the Referee in the Finkelstein case follows:

"The Collector's claim * * * asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment [fol. 57] before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.

The question of priority and of rate of interest will be reserved by the Referee for the present.

The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourth- aggregating $11,523.30 form the basis of the present claim.

On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.

It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 15, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interest in the partnership at that time.

At the hearing it appeared that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property of Abraham Finkelstein. It was conceded Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is however conceded that in this there is no surplus.

At the hearing the government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general copartnership creditors.

At the hearing the Trustee contended that the government's claim was only payable out of any individual assets (of which in this case [fol. 58] there were none) belonging to the individual estate of Abraham Finkelstein within subdiv. f of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

'That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *'

It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly imposed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

'Sec. 218 (a). That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner [fol. 59] his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.'

'Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.'

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled 'Part II—individuals.'

In my opinion the sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.; Section 218 (a) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdiv. f of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkelstein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

[fol. 60] I find nothing in Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the res which the Collector may seize. Those three sections read as follows:

'If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United

States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *.'

'Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.'

'Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.'

[fol. 61] Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets, which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finkelstein as an individual under Section 218 (a) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above.

Congress having deliberately chosen the plan of taxation indicated in those sections, instead of assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Col-

[fol. 62] lector is precluded from asserting the different rule here contended for by him, even if (as he points out) the statutory plan works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner 'in his individual capacity.'

I read the following cases as supporting the views expressed in this memorandum:

U. S. v. Hack, 8 Peters, 271;
U. S. v. Evans, Crabbe, 60; 2 Fed. Cases, #15062.

The Collector relies on the following cases:

In re Straussberger, 4 Wood, 557, 23 Fed. Cases, #13526;
Lewis v. U. S., 92 U. S., 618.

In the Straussberger cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claims of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning 'When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc.'

I cannot read the Lewis case as impairing the prior decision of the U. Supreme Court in U. S. v. Hack. The facts were as follows:

The United States had a claim against the partnership of Jay [fol. 63] Cook McCulloch & Co. of London, hereafter called the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States.

The Supreme Court merely decided that the United States holding a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis, the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector, that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors, which is the proposition condemned in U. S. v. Hack, supra.

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Rev-

enue against the partnership assets of Finkelstein Brothers in priority against the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy."

[fol. 64] Robert P. Lewis (Max E. Sanders, of Counsel), for Appellee, Henry H. Kaufman, Trustee.

White & Case (Lyle T. Alverson, Alfred C. Coxe, J. M. Hartfield, Henry H. Kaufman, Wm. St. John Tozer and Ralph Wolf, of Counsel), for Receiver Coxe.

William Hayward, U. S. Attorney; Nelson T. Hartson, Solicitor of Internal Revenue, Russell N. Shaw, Special Attorney, Bureau of Internal Revenue, and Victor House, Special Asst. U. S. Attorney, for Appellants.

Mayer, Circuit Judge:

The fundamental fallacy of the contention on behalf of the Government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible.

The authority to tax must be found somewhere. The Revenue Act of 1918, in Section 1400 thereof, specifically repealed, inter alia, Title I including Section 8 (e) of the Revenue Act of 1916 and Title II, including Section 201 of the Revenue Act of 1917.

The provisions of the tax statute here concerned are thus Section 218 (a) and Section 224 of Title II of the Revenue Act of 1918. As pointed out in the opinion of the Referee, supra, there is not the slightest warrant for concluding that the tax was against partnerships and not solely against the "individuals carrying on business in partnerships." The language of Section 218 (a) is too plain for extended discussion and its meaning could be fortified, if necessary, by the contrast between the Revenue Act of 1917 and the Revenue Act of 1918 in this regard.

As, therefore, there was no income tax against the partnership in either of the cases at bar, we must look to the bankruptcy statute to [fol. 65] ascertain whether it affirmatively provided that the tax assessed against the individuals could be proved against the partnership estate. We need not pause to consider what distinction, if any, there is between "debts" and "taxes" in various parts of the Bankruptcy Act. We may also assume for the purpose of the argument that, if the Revenue Act of 1918 authorized assessment of the tax against the partnership instead of against the individuals, it might not have been necessary to name the United States in any provision as to marshalling.

The point, however, is that, as there is no tax against the partnership, the only remaining theory upon which the tax against the individuals can be proved against and recovered out of the partnership estate is that the Bankruptcy Act of 1898 so provided.

Section 5, subdivision (f) of that Act did not so provide. This provision reads:

"The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnerships."

There can be no longer any doubt that the distinction between individual and firm debts is a matter of substance which cannot be disregarded.

[fol. 66] In re Wilcox, 94 F. R., 84;
In re Janes, 133 F. R., 912;
In re Schall v. Camora, 251 U. S., 239;
In re Jarmulowsky, 287 F. R., 703.

There is, of course, no doubt that the right of priority of the United States in the collection of taxes is an attribute of sovereignty.
Marshall v. New York, 254 U. S., 380.

Under Section 64 (a) of the Bankruptcy Act of 1898, it is the duty of the court to order the trustee to pay all taxes, legally due and owing by the bankrupt to the United States, in advance of the payment of dividends to creditors; but, of course, the tax must be "legally due and owing by the bankrupt to the United States."

U. S. R. S., Sections 3186, 3466 and 3467 deal with tax priority, but there is nothing in the provisions of these sections which changes the tax against an individual into a tax against the partnership. Numerous instances will be found in the case of In re Wilson. 252 F. R., 631, which illustrate the difference between the identity of the fund or person against whom a claim can be made and respective priorities once the fund or person is found or determined. If, therefore, the Congress had intended that the tax against the individuals should be paid out of the partnership estate prior to the payment of the partnership debts it would have so declared by some affirmative language to that effect either in section 5 (f) of the statute or in some other provision.

It must be remembered that the Bankruptcy Act of 1898 has now been in operation for a little over a quarter of a century and that business has been done on the faith and basis of the statute. It can [fol. 67] readily be seen that a partnership might not be able to obtain the same amount of credit from banks and other lending sources if in marshalling the assets of a partnership, such assets become a fund out of which the debts or taxes due and owing from the individual members are payable prior to or pari passu with the partnership debts.

As pointed out by Judge Rogers in United States v. Wood, 290 F. R., 109, there is a marked difference between the Act of 1898

and previous acts in respect of the relation of the United States to the present bankruptcy act. In the case just cited, there is a review of many cases illustrative of this proposition. It is hard to believe, in view of the definite language of Section 5 (f) that the legislature intended to create a situation where the debts or taxes due from the individuals might either wipe out or share with the debts due from the partnership; for any such provision might well have been most detrimental to business and commerce. Of course, it is always within the power of the Congress to tax the partnership as distinguished from the individuals, but where, as here, no such tax exists, we confess that we are unable to find anywhere in the Bankruptcy Act of 1898 any provision which authorizes the collection of the tax from property which was never taxed.

United States v. Hack, 8 Peters, 271;
United States v. Evans, 25 Fed. Cases, 1023.

The cases of Lewis v. United States, 92 U. S., 618, and In re Strassburger, 23 Fed. Case, 224, have been analyzed in the opinion of the Referee and the Lewis case has been further commented upon in the Wood case, supra, at pages 111 et seq.

Our attention has been called to a decision of the District Court of New Jersey in the Matter of Brezin & Schaefer, not reported. We are unable to agree with this decision. (Note.) There is nothing

[fol. 68] in the record of either of the cases at bar upon which an equitable lien against the partnership assets may be asserted in favor of the United States. "Equitable lien" is often used synonymously with "equitable assignment" and "impressing a trust." An excellent definition is found in Lighthouse v. Third National Bank, 162 N. Y., at page 344:

"One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.

Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge."

See also,

Pomeroy on Equity, Fourth Edition, Vol. 3, Section 1233;
Bispham on Equity, 4th Edition, Sec. 351;
Ketchum v. St. Louis, 101 U. S., 306;
Walker v. Brown, 165 U. S., 654;
National City Bank v. Hotchkiss, 231 U. S., 50, 57;
In re National Cash Register Co., 174 F. R., 579;
In re See, 209 F. R., 172.

(Note.)—See interesting article in Columbia Law Review, April, 1924, entitled "The Priority of the United States in the Payment of its Claims against a Bankrupt" by Ralph F. Colin, at pages 360, 371 and 372.

Every element of an equitable lien is absent in each of the cases here under consideration.

Finally, there is no merit in the suggestion that the marshalling provisions are not applicable in the Jones & Baker case because there the composition in that case was had before adjudication. The composition was only with the partnership creditors and there was no [fol. 69] composition with the creditors of the individual partners. This was warranted by Section 12 of the Bankruptcy Act, as amended June 25, 1910. In re Breitbart, 291 F. R., 693.

A composition whether before or after adjudication, so far as affects the questions here presented, stands in the same position as a liquidation through a trusteeship in bankruptcy. (See opinion of Referee Remington, Matter of Simon Fox, 6 A. B. R., 525, 530.)

It is plain that under the Bankruptcy Act, it is intended that its administrative sections shall apply whichever method of administration ma ybe chosen.

We think it unnecessary to comment in detail upon many cases cited in the briefs. It is sufficient to observe that three cases upon which some emphasis is laid by appellant, i. e., Matter of Menist, 294 F. R., 532, U. S. v. McHatton, et al., 266 F. R., 602 and Titus v. Maxwell, 281 F. R., 433, either are not relevant to the question here under consideration or contain nothing to disturb the conclusion that the decrees below were correct.

Decrees affirmed.

[fols. 70 & 71] In United States Circuit Court of Appeals

[Title omitted]

Judgment—Filed April 14, 1924

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

H. W. R.
J. M. M.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

[fol. 72] IN UNITED STATES CIRCUIT COURT OF APPEALS

CLERK'S CERTIFICATE

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby Certify that the foregoing pages, numbered from 1 to 71 inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Abraham Finkelstein et al., Individually, etc., Bankrupts; Frank K. Bowers, as Collector, etc., Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 23rd day of June in the year of our Lord One Thousand Nine Hundred and twenty-four and of the Independence of the said United States the One Hundred and forty-eighth.

William Parkin, Clerk. (Seal of United States Circuit Court of Appeals, Second Circuit.)

[fol. 72a] IN SUPREME COURT OF THE UNITED STATES

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

ORDER GRANTING PETITION FOR CERTIORARI—Filed Oct. 13, 1924

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Second Circuit, and of the argument of counsel thereupon had, as well in support of as against the same, it is now here ordered by this Court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.

[fol. 73] IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

No. 34907

In the Matter of the Petition of CLYDE W. POPE, JOSEPH M. WILliams, Robert S. Dodge to Have the Firm of Jones & Baker and William R. Jones and Jackson B. Sells, Doing Business as Copartners under the Firm Name and Style of Jones & Baker, Individually and as Members of the Firm of Jones & Baker, Adjudicated Bankrupts

ORDER TO SHOW CAUSE

Upon the annexed affidavit of Alfred C. Coxe, Jr., as Receiver, it is Ordered, that the United States show cause before me at Courtroom 2, in the Woolworth Building, on the 19th day of December, 1923, at 2:30 o'clock in the afternoon of said day, why an order should not be entered herein disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker, the claim of $273,-739.07 for income tax assessed against William R. Jones and the claim of $5,518.41 for income tax assessed against Jackson B. Sells; service of a copy of this order on the Collector of Internal Revenue for the Second District of New York and upon the United States Attorney for the Southern District of New York on or before the 17th day of December, 1923, shall be sufficient.

Henry W. Goddard, U. S. D. J.

[fol. 74] IN THE UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF ALFRED C. COXE, JR.

Alfred C. Coxe, Jr., being duly sworn, says:

I. That on the 31st day of May, 1923, he was duly appointed Receiver herein.

II. That claims for $273,739.07, representing income tax assessed against William R. Jones, and for $5,518.41 representing income tax assessed against Jackson B. Sells, have been filed, on behalf of the United States, with deponent as Receiver and are asserted to be claims against the assets of the firm of Jones & Baker, and the said partnership estate.

[fol. 75] III. That the actual realizable value of the assets of the firm of Jones & Baker which have come into the possession of depo-

nent as Receiver are now insufficient in amount to pay in full all of the allowable claims of creditors of said partnership estate.

IV. That the tax upon which said claims are based was assessed against said William R. Jones and said Jackson B. Sells, as individuals.

Wherefore, deponent asks that said claims be disallowed and expunged as claims against the estate and assets of the firm or partnership of Jones & Baker, and that an order to show cause be issued directing the United States to show cause why said claims should not be disallowed and expunged, and for such other and further relief as may be proper.

Alfred C. Coxe, Jr.

Sworn to before me this 14th day of December, 1923. James McCarron, Notary Public, Kings Co., No. 24. Certificate filed New York Co. (Seal.)

[fol. 76] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT IN SUPPORT OF MOTION TO EXPUNGE INCOME TAX CLAIMS

STATE OF NEW YORK,
County of New York, ss:

Alfred C. Coxe, Jr., being first duly sworn on oath, says that on the 26th day of November, 1923, an offer of composition in bankruptcy, dated November 23, 1923, was made and filed in this Court on behalf of the said above mentioned bankrupts, a copy of which offer is hereto annexed, marked "Exhibit A," and made a part of this affidavit, and that a motion to confirm said offer has been duly made and is now pending in this Court.

That on or about the 30th day of July, 1923, the Collector of Internal Revenue for the Second Collection District of New York filed a claim, dated July 14, 1923, against this estate for taxes against [fol. 77] William R. Jones in the sum of $632,768.04, and a claim dated July 14, 1923, for taxes against Jackson B. Sells in the sum of $62,661.89. That subsequently, and under date of November 26, 1923, the Secretary of the Treasury and the Collector of Internal Revenue of the United States entered into a stipulation and agreement with William R. Jones, and a stipulation and agreement with Jackson B. Sells, in respect of said above mentioned claims, copies of which said two stipulations and agreements are hereto annexed, marked "Exhibits B" and "C," respectively, and made a part of this affidavit.

That under and in accordance with such stipulations and agreements above referred to, the claim against the said Jones has been reduced to $273,739.07, and the claim against the said Sells has been reduced to $5,518.41.

This affidavit is submitted on the motion made by deponent for the disallowance and expunging of the claims of the United States Government against the estate and assets of the firm of Jones & Baker on account of taxes of said Jones and Sells above referred to, and for an order directing the United States to show cause why such claim should not be disallowed and expunged.

Alfred C. Coxe, Jr.

Sworn to before me this 9th day of January, 1924. James McCarron, Notary Public, Kings County, No. 24. Certificate filed — New York Co., No. 110. Register's Nos., Kings, 4022, N. Y., 4099. Commission expires March 30, 1924. (Seal.)

[fol. 78] EXHIBIT A TO AFFIDAVIT

[Title omitted]

To the Honorable Judges of the District Court of the United States for the Southern District of New York and the creditors of the above-named alleged bankrupts:

The undersigned, William R. Jones and Jackson B. Sells, individually and as members of the firm of Jones & Baker, and the firm of Jones & Baker, being persons against whom an involuntary petition for adjudication in bankruptcy was heretofore filed herein in this Court, and the schedules of property and list of creditors of which [fol. 79] said individuals and firm have been duly filed in this Court, do hereby offer to the partnership customers and creditors of the firm of Jones & Baker under and pursuant to the Acts of Congress relating to Bankruptcy, and all amendments thereto, now in force, the following Plan of composition:

I. The claims of customers and creditors of the firm of Jones & Baker shall be liquidated by giving the securities, if any, in their respective accounts, the value of the prices obtainable at the close of business on May 31, 1923. All claims shall be paid upon such liquidated basis, and to effect such payment there shall be available when the composition is made operative, cash and New York Curb Market and New York or Chicago Stock Exchange securities, so valued of an aggregate amount and value equal to the aggregate amount of at least 90% of such claims so liquidated.

II. Payment shall be made as follows:

(a) Payment from Cash. Cash shall be paid to each of such customers or creditors of the firm of Jones & Baker in an amount of at

least 50% of their respective claims so liquidated, which cash shall be made available to customers and creditors of the firm of Jones & Baker upon entry of the order confirming the composition;

(b) Payment from securities. The difference between the aggregate of payments from cash to be made under paragraph (a) hereof and the aggregate of all claims so liquidated, shall be represented by securities dealt in or listed on May 31, 1923, on the New York Curb [fol. 80] Market and on the New York or Chicago Stock Exchanges, having, in the aggregate, a value (at the prices obtainable at the close of business on May 31, 1923), equal to such difference; or such cash and securities valued as above provided shall aggregate in amount and value at least 90% of all such claims so liquidated. Such securities (in the possession of the Receiver when the composition is made effective), shall be sold as and when the Receiver may elect and the proceeds of sale of all such securities shall be paid pro rata to such customers and creditors of the firm of Jones & Baker according to their respective credit balances so liquidated, and without deduction of any kind other than the usual brokerage commission to be paid in effecting the sales. The time and method of such sales and the distribution of proceeds shall be provided for in the order confirming the composition.

III. Jones & Baker shall pay, or cause to be paid, all the expenses of administration and of liquidation (other than the brokerage commission mentioned in paragraph [b] of II hereof) and all the expenses of the composition and of the Customers' and Creditors' Committee, and the fees of all counsel as fixed by the Court when the plan of composition or settlement shall have been confirmed.

Dated, New York, November 23, 1923.

William R. Jones, Jackson B. Sells, Individually and as Members of the Firm of Jones & Baker. Jones & Baker, by William R. Jones.

[fol. 81] EXHIBIT B TO AFFIDAVIT

Agreement

This Agreement, made this 26th day of November, 1923, under and in pursuance of Section 1312 of the Revenue Act of 1921, by and between William R. Jones (hereinafter referred to as the taxpayer), residing at New York City, New York, and the Commissioner of Internal Revenue (hereinafter referred to as the Commissioner), with the approval of the Secretary of the Treasury, Witnesseth:

Whereas, on or about the eleventh day of July, 1923, there was a determination by the Commissioner that the sum of $534,149.42 was the correct amount of net additional income taxes for the calendar years 1918, 1919 and 1920, under the provisions of the Act of Feb-

ruary 24, 1919, and the provisions of the Act — November 23, 1921, for which the taxpayer was liable, and

Whereas, on or about the fifteenth day of November, 1923, there was a final determination by the Commissioner that the net additional income tax liability of the said William R. Jones, for the years 1918, 1919 and 1920, is the principal sum of $273,739.07 (exclusive of any interest and penalties), and same was duly assessed, and

Whereas, the taxpayer has accepted an abatement of $260,410.35 from previous assessments made in arriving at said outstanding balance of $273,739.07.

Now, therefore, the taxpayer and the Commissioner, with the ap- [fol. 82] proval of the Secretary of the Treasury, hereby mutually agree that the sum of $273,739.07 is the correct amount of the principal additional tax (exclusive of interest and penalties), for which the taxpayer was and is liable on account of his income tax for the years 1918, 1919 and 1920, and that said sum is final and conclusive, as provided in Section 1312 of the Revenue Act of 1921.

In testimony whereof the parties to this agreement have hereunto set their hands and seals in duplicate.

William R. Jones, Taxpayer. (L. S.) Alfred C. Coxe, Jr., Receiver for Taxpayer. (L. S.) D. W. Blair, Commissioner of Internal Revenue. A. W. Mellon, Secretary of the Treasury, M. M.

R. D. Wilson, Notary Public, New York County, No. 268. N. Y. County Register's No. 4182. Commission expires March 30, 1924.

[fol. 83] EXHIBIT C TO AFFIDAVIT

This agreement made this 26 day of November, 1923, — pursuance of Section 1312 of the Revenue Act of 1921, by and between Jackson B. Sells (hereinafter referred to as the taxpayer), residing at New York City, New York, and the Commissioner of Internal Revenue (hereinafter referred to as the Commissioner) with the approval of the Secretary of the Treasury Witnesseth:

Whereas, on or about the Eleventh day of July, 1923, there was a determination by the Commissioner that the sum of $54,862.02 was the correct amount of net additional income taxes for the calendar years 1918, 1919 and 1920, under the provisions of the Act of February 24, 1919, and the provisions of the Act of November 23, 1921, for which the taxpayer was liable, and

Whereas, on or about the Fifteenth day of November 1923, there was a final determination by the Commissioner that the net additional income tax liability of the said Jackson B. Sells, for the years 1918, 1919 and 1920, is the principal sum of $5,518.41 (exclusive of any interest and penalties), and same was duly assessed, and

Whereas, the taxpayer has accepted an abatement of $49,343.61, from previous assessments made in arriving at said outstanding balance of $5,518.41.

Now, therefore, the taxpayer and the Commissioner, with the approval of the Secretary of the Treasury, hereby mutually agree that the sum of $5,518.41 is the correct amount of the principal additional [fol. 84] tax (exclusive of interest and penalties), for which the taxpayer was and is liable on account of his income tax for the years 1918, 1919 and 1920, and that said sum is final and conclusive, as provided in Section 1312 of the Revenue Act of 1921.

In testimony whereof the parties to this agreement have hereunto set their hands and seals in duplicate.

Jackson B. Sells, Taxpayer. (L. S.) Alfred C. Coxe, Jr., Receiver for Taxpayer. (L. S.) D. W. Blair, Commissioner of Internal Revenue. A. W. Mellon, Secretary of the Treasury. M. M.

R. D. Wilson, Notary Public, New York County, No. 268. N. Y. County Register's No. 4182. Commission expires March 30, 1924.
Approved Dec. 11, 1923.

[fol. 85] IN UNITED STATES DISTRICT COURT

[Title omitted]

STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that W. R. Jones, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended.—1920, Wash. July 1923 list. Spec. #7, #945818.

Amount of Tax.—$632,768.04.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

That no security therefor is held by the United States and that there be no set-offs or counter-claims.

[fol. 86] That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall be-

come answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 14th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 14th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924. (Seal.)

[fol. 87] In United States District Court

[Title omitted]

Amended Statement of Claims for Taxes Due the United States

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that W. R. Jones, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended.—1920—Wash. July 1923, spec. #7 list.

Amount of tax—$534,149.42.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

[fol. 88] That no security therefor is held by the United States and that there be no set-offs or counterclaims.

That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 26th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 26th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924.

[fol. 89] IN UNITED STATES DISTRICT COURT

[Title omitted]

STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that Jackson B. Sells, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended—1920—Wash. June 1923 List Spec. #3, P. O., L. O. #945815.

Amount of tax—$62,661.89.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

That no security therefor is held by the United States and that there be no set-offs or counterclaims.

[fol. 90] That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 14th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 14th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924. (Seal.)

[fol. 91] IN UNITED STATES DISTRICT COURT

[Title omitted]

AMENDED STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that Jackson B. Sells, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended.—1920—Wash. June 1923 list, page O, line O.

Amount of tax—$54,872.02.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York.

[fol. 92] That no security therefor is held by the United States and that there be no set-offs or counterclaims.

That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from his own person and estate for the debts so due to such person or estate, shall become answerable in the United States, or for so much thereof as may remain due and unpaid.

Dated this 26th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 26th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924. (Seal.)

[fol. 93] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE PROOF OF PRIORITY OF CLAIM

It is hereby stipulated that if the Court is of the opinion that the question is material whether the taxes herein involved and asserted by the United States as being entitled to priority of payment out of the partnership assets of Jones & Baker are based on partnership income rather than on individual sources of income of the respective partners of Jones & Baker further proof may be offered respecting the sources of the income giving rise to the tax claims herein asserted.

White & Case, Attorneys for Receiver. Wm. Hayward, United States Attorney.

[fol. 94] IN UNITED STATES DISTRICT COURT

MEMORANDUM DECISION—JUDGE GODDARD

(Memorandum Endorsed on Moving Papers)

The question involved herein has been recently passed upon by this Court in the Matter of Finklestein, which decision after examination of the law, I concur in. This motion is accordingly granted.

Henry W. Goddard.

January 23, 1924.

IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF APPEAL

SIRS: Please take notice that the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second Dis-[fol. 95] trict of New York, hereby appeal from the order and decree of the United States District Court for the Southern District of New York, made by Honorable Henry W. Goddard, one of the Judges hereof, and entered herein on the 26th day of January, 1924, disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker, the claim of $273,739.07 for income tax assessed against William R. Jones, and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, the individual members comprising the said firm of Jones & Baker, from each and every part of said decree and from the whole thereof to the Circuit Court of Appeals for the Second Circuit to be held in and for the said

Circuit at the United States Courts and Post Office Building in the Borough of Manhattan, City of New York.

Dated, New York, February 4, 1924.

Yours, etc., William Hayward, United States Attorney for the Southern District of New York, Attorney for United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York.

Office & P. O. Address, U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

To White & Case, Esqs., Attorneys for Receiver, 14 Wall Street, New York City; Alexander Gilchrist, Jr., Esq., Clerk of the District Court of the United States for the Southern District of New York.

[fol. 96] In United States District Court

[Title omitted]

Assignments of Error

Now come the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, and file the following assignment of errors:

1. That the order of the United States District Court for the Southern District of New York, dated and filed the 26th day of January, 1924, is erroneous and contrary to law.

2. That the United States District Court for the Southern District of New York in its said order dated January 26, 1924, erred in disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker the claim of $273,739.07 for income [fol. 97] tax assessed against William R. Jones and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, individual members comprising the said firm of Jones & Baker.

3. That the said Court in its order dated January 26, 1924, erred in refusing to allow the said claim of $273,739.07 for income tax assessed against William R. Jones, and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, the individual members comprising the said firm of Jones & Baker, as priority claims to be paid out of the assets of the said firm of Jones & Baker in advance of payment of the claims of the general creditors of said firm.

Wherefore, the United States of America prays that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and

decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein allowing said claims of the United States of America as filed, as priority claims against the firm assets of Jones & Baker entitled to payment in advance of the payment of dividends to general firm creditors.

Dated, New York, February 4, 1924.

William Hayward, United States Attorney for the Southern District of New York.

[fol. 98] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AND ORDER ALLOWING APPEAL

To the Honorable the Judges of the United States District Court for the Southern District of New York:

The United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, feeling aggrieved by the order and decree of the United States District Court for the Southern District of New York, made by the Honorable Henry W. Goddard, one of the Judges thereof and entered herein on the 26th day of January, 1924, in the above entitled proceeding, disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker, the claim of $273,739.07 for income tax [fol. 99] assessed against William R. Jones, and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, the individual members comprising the said firm of Jones & Baker, whereas the Court should have directed the payment of the aforesaid income tax claims out of the estate and assets of the said firm of Jones & Baker in advance of payment to the creditors of said firm, do hereby petition for an appeal upon the said order and decree to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Dated, New York, February 4, 1924.

United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, by William Hayward, United States Attorney for the Southern District of New York.

The foregoing appeal is hereby allowed.

Henry W. Goddard, U. S. D. J.

[fol. 100] In United States District Court

[Title omitted]

Order Disallowing and Expunging Tax Claims

Upon the petition of Alfred C. Coxe, Jr., receiver herein, the proofs of claim filed with the receiver by the United States Government against William R. Jones and Jackson B. Sells, and the stipulations entered into reducing said claim, and the additional affidavit of said receiver, it is hereby

Ordered that the claims filed herein by the United States for income taxes due from William R. Jones in the amount of $273,739.07, and from Jackson B. Sells in the amount of $5,518.41, be disallowed and expunged as claims against the assets of the firm of Jones & Baker.

Henry W. Goddard, U. S. D. J.

[fol. 101] Citation—In usual form; omitted in printing

[fol. 102] In United States District Court

[Title omitted]

Stipulation re Transcript of Record

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed on by the parties.

New York, March 13th, 1924.

Wm. Hayward, United States Attorney, Attorney for Appellant. White & Case, Attorneys for Appellee.

[fols. 103 & 104] In United States District Court

[Title omitted]

Clerk's Certificate

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this 13th day of March, in the year of our Lord one thousand nine hundred and twenty-four and of the Independence of the said United States the one hundred and forty-ninth.

Alexander Gilchrist, Jr., Clerk.

39657.

[fol. 105] In United States Circuit Court of Appeals for the Second Circuit, October Term, 1923

Nos. 267-338

Argued March 17, 1924. Decided April 7, 1924

In the Matter of Abraham Finkelstein, Israel Finkelstein, and Nettie Finkelstein, Individually and as Copartners, Trading as Finkelstein Bros., Bankrupts

Re Claim of Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, for $11,523.30

United States of America and Frank K. Bowers, as Collector of Internal Revenue for the Second District of New York, Appellant,

v.

Henry H. Kaufman, Trustee in Bankruptcy, Appellee

In the Matter of Jones & Baker, Alleged Bankrupts

Appeal from the District Court of the United States for the Southern District of New York

Before Rogers, Hough, and Mayer, Circuit Judges

Opinion

These two appeals were argued at the same time and will be disposed of in one opinion.

In the Finkelstein case the District Court for the Southern Dis-[fol. 106] trict of New York affirmed the order of the Referee in bankruptcy allowing the claim of Bowers Collector against the individual assets of Finkelstein, but not against the partnership assets. The facts are sufficiently set forth in the opinion of Referee Townsend which, because of its careful review of the question litigated, we quote infra.

In the Jones & Baker case, the District Court for the Southern District of New York reached the same conclusion on a different

state of facts, in respect of which, however, there is no difference in principle from what was held in the Finkelstein case.

The facts in the Jones & Baker case may be briefly stated.

Jones & Baker was a partnership composed of two partners, William R. Jones and Jackson B. Sell, and was engaged in the stock brokerage business. On March 31, 1923, an involuntary bankruptcy proceeding was commenced against the firm in the District Court for the Southern District of New York and a receiver was appointed.

An offer of composition in bankruptcy was made by the firm to the partnership customers and creditors, as distinguished from the creditors of the individual partners, which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. No offer of composition was made to the creditors of the individual partners. This offer of composition was confirmed by the District Court, and the Receiver was directed to carry it into effect. Under the composition the creditors of the firm cannot by any possibility recover the full amount of their claims.

In July, 1923, more than one month after the appointment of the receiver, the government, upon a re-examination of the individual tax returns of the individual partners, for the years 1918, 1919 and 1920, assessed certain additional income taxes against [fol. 107] Jones for $632,768.04 and Sells for $62,661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts.

As the result of negotiations, a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned.

The Government, however, has endeavored in the bankruptcy proceeding to assert these claims as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the use and benefit of the creditors of the firm and has endeavored to enforce the two claims as being entitled to payment out of the firm's assets prior to the customers and creditors of the firm.

The opinion of the Referee in the Finkelstein case follows:

"The Collector's claim * * * asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment [fol. 108] before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.

The question of priority and of rate of interest will be reserved by the Referee for the present.

The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourth- aggregating $11,523.30 form the basis of the present claim.

On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.

It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 15, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interest in the partnership at that time.

At the hearing it appeared that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property of Abraham Finkelstein. It was conceded Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is however conceded that in this there is no surplus.

At the hearing the government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general copartnership creditors.

At the hearing the Trustee contended that the government's claim was only payable out of any individual assets (of which in this case [fol. 109] there were none) belonging to the individual estate of Abraham Finkelstein within subdiv. f of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

'That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *'

It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the

Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly imposed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

'Sec. 218 (a). That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner [fol. 110] his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.'

'Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.'

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled 'Part II—individuals.'

In my opinion the sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.; Section 218 (a) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdiv. f of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkelstein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

[fol. 111] I find nothing in Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the res which the Collector may seize. Those three sections read as follows:

'If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the in-

terest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *.'

'Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.'

'Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.'

[fol. 112] Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets, which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finkelstein as an individual under Section 218 (a) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above.

Congress having deliberately chosen the plan of taxation indicated in those sections, instead of assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Col- [fol. 113] lector is precluded from asserting the different rule here contended for by him, even if (as he points out) the statutory plan

works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner 'in his individual capacity.'

I read the following cases as supporting the views expressed in this memorandum:

U. S. v. Hack, 8 Peters, 271;
U. S. v. Evans, Crabbe, 60; 2 Fed. Cases, #15062.

The Collector relies on the following cases:

In re Straussberger, 4 Wood, 557, 23 Fed. Cases, #13526;
Lewis v. U. S., 92 U. S., 618.

In the Straussberger cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claims of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning 'When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc.'

I cannot read the Lewis case as impairing the prior decision of the U. Supreme Court in U. S. v. Hack. The facts were as follows:

The United States had a claim against the partnership of Jay [fol. 114] Cook McCulloch & Co. of London, hereafter called the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States.

The Supreme Court merely decided that the United States holding a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis, the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector, that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors, which is the proposition condemned in U. S. v. Hack, supra.

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Revenue against the partnership assets of Finkelstein Brothers in priority against the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy."

[fol. 115] Robert P. Lewis (Max E. Sanders, of Counsel), for Appellee, Henry H. Kaufman, Trustee.

White & Case (Lyle T. Alverson, Alfred C. Coxe, J. M. Hartfield, Henry H. Kaufman, Wm. St. John Tozer and Ralph Wolf, of Counsel), for Receiver Coxe.

William Hayward, U. S. Attorney; Nelson T. Hartson, Solicitor of Internal Revenue, Russell N. Shaw, Special Attorney, Bureau of Internal Revenue, and Victor House, Special Asst. U. S. Attorney, for Appellants.

Mayer, Circuit Judge:

The fundamental fallacy of the contention on behalf of the Government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible.

The authority to tax must be found somewhere. The Revenue Act of 1918, in Section 1400 thereof, specifically repealed, inter alia, Title I including Section 8 (e) of the Revenue Act of 1916 and Title II, including Section 201 of the Revenue Act of 1917.

The provisions of the tax statute here concerned are thus Section 218 (a) and Section 224 of Title II of the Revenue Act of 1918. As pointed out in the opinion of the Referee, supra, there is not the slightest warrant for concluding that the tax was against partnerships and not solely against the "individuals carrying on business in partnerships." The language of Section 218 (a) is too plain for extended discussion and its meaning could be fortified, if necessary, by the contrast between the Revenue Act of 1917 and the Revenue Act of 1918 in this regard.

As, therefore, there was no income tax against the partnership in either of the cases at bar, we must look to the bankruptcy statute to [fol. 116] ascertain whether it affirmatively provided that the tax assessed against the individuals could be proved against the partnership estate. We need not pause to consider what distinction, if any, there is between "debts" and "taxes" in various parts of the Bankruptcy Act. We may also assume for the purpose of the argument that, if the Revenue Act of 1918 authorized assessment of the tax against the partnership instead of against the individuals, it might not have been necessary to name the United States in any provision as to marshalling.

The point, however, is that, as there is no tax against the partnership, the only remaining theory upon which the tax against the individuals can be proved against and recovered out of the partnership estate is that the Bankruptcy Act of 1898 so provided.

Section 5, subdivision (f) of that Act did not so provide. This provision reads:

"The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnerships."

There can be no longer any doubt that the distinction between individual and firm debts is a matter of substance which cannot be disregarded.
[fol. 117] In re Wilcox, 94 F. R., 84;
In re Janes, 133 F. R., 912;
In re Schall v. Camora, 251 U. S., 239;
In re Jarmulowsky, 287 F. R., 703.

There is, of course, no doubt that the right of priority of the United States in the collection of taxes is an attribute of sovereignty.
Marshall v. New York, 254 U. S., 380.

Under Section 64 (a) of the Bankruptcy Act of 1898, it is the duty of the court to order the trustee to pay all taxes, legally due and owing by the bankrupt to the United States, in advance of the payment of dividends to creditors; but, of course, the tax must be "legally due and owing by the bankrupt to the United States."

U. S. R. S., Sections 3186, 3466 and 3467 deal with tax priority, but there is nothing in the provisions of these sections which changes the tax against an individual into a tax against the partnership. Numerous instances will be found in the case of In re Wilson, 252 F. R., 631, which illustrate the difference between the identity of the fund or person against whom a claim can be made and respective priorities once the fund or person is found or determined. If, therefore, the Congress had intended that the tax against the individuals should be paid out of the partnership estate prior to the payment of the partnership debts it would have so declared by some affirmative language to that effect either in section 5 (f) of the statute or in some other provision.

It must be remembered that the Bankruptcy Act of 1898 has now been in operation for a little over a quarter of a century and that business has been done on the faith and basis of the statute. It can [fol. 118] readily be seen that a partnership might not be able to obtain the same amount of credit from banks and other lending sources if in marshalling the assets of a partnership, such assets become a fund out of which the debts or taxes due and owing from the individual members are payable prior to or pari passu with the partnership debts.

As pointed out by Judge Rogers in United States v. Wood, 290 F. R., 109, there is a marked difference between the Act of 1898

and previous acts in respect of the relation of the United States to the present bankruptcy act. In the case just cited, there is a review of many cases illustrative of this proposition. It is hard to believe, in view of the definite language of Section 5 (f) that the legislature intended to create a situation where the debts or taxes due from the individuals might either wipe out or share with the debts due from the partnership; for any such provision might well have been most detrimental to business and commerce. Of course, it is always within the power of the Congress to tax the partnership as distinguished from the individuals, but where, as here, no such tax exists, we confess that we are unable to find anywhere in the Bankruptcy Act of 1898 any provision which authorizes the collection of the tax from property which was never taxed.

United States v. Hack, 8 Peters, 271;
United States v. Evans, 25 Fed. Cases, 1023.

The cases of Lewis v. United States, 92 U. S., 618, and In re Strassburger, 23 Fed. Case, 224, have been analyzed in the opinion of the Referee and the Lewis case has been further commented upon in the Wood case, supra, at pages 111 et seq.

Our attention has been called to a decision of the District Court of New Jersey in the Matter of Brezin & Schaefer, not reported. We are unable to agree with this decision. (Note.) There is nothing [fol. 119] in the record of either of the cases at bar upon which an equitable lien against the partnership assets may be asserted in favor of the United States. "Equitable lien" is often used synonymously with "equitable assignment" and "impressing a trust." An excellent definition is found in Lighthouse v. Third National Bank, 162 N. Y., at page 344:

"One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.

Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge."

See also.

Pomeroy on Equity, Fourth Edition, Vol. 3, Section 1233;
Bispham on Equity, 4th Edition, Sec. 351;
Ketchum v. St. Louis, 101 U. S., 306;
Walker v. Brown, 165 U. S., 654;
National City Bank v. Hotchkiss, 231 U. S., 50, 57;
In re National Cash Register Co., 174 F. R., 579;
In re See, 209 F. R., 172.

(NOTE.)—See interesting article in Columbia Law Review, April, 1924, entitled "The Priority of the United States in the Payment of its Claims against a Bankrupt" by Ralph F. Colin, at pages 360, 371 and 372.

Every element of an equitable lien is absent in each of the cases here under consideration.

Finally, there is no merit in the suggestion that the marshalling provisions are not applicable in the Jones & Baker case because there the composition in that case was had before adjudication. The composition was only with the partnership creditors and there was no [fol. 120] composition with the creditors of the individual partners. This was warranted by Section 12 of the Bankruptcy Act, as amended June 25, 1910. In re Breitbart, 291 F. R., 693.

A composition whether before or after adjudication, so far as affects the questions here presented, stands in the same position as a liquidation through a trusteeship in bankruptcy. (See opinion of Referee Remington, Matter of Simon Fox, 6 A. B. R., 525, 530.)

It is plain that under the Bankruptcy Act, it is intended that its administrative sections shall apply whichever method of administion may be chosen.

We think it unnecessary to comment in detail upon many cases cited in the briefs. It is sufficient to observe that three cases upon which some emphasis is laid by appellant, i. e., Matter of Menist, 294 F. R., 532, U. S. v. McHatton, et al., 266 F. R., 602 and Titus v. Maxwell, 281 F. R., 433, either are not relevant to the question here under consideration or contain nothing to disturb the conclusion that the decrees below were correct.

Decrees affirmed.

[fol. 121] In United States Circuit Court of Appeals

[Title omitted]

Judgment—Filed April 14, 1924

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

H. W. R.
J. M. M.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

[fol. 122] In United States Circuit Court of Appeals

Clerk's Certificate

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby Certify that the foregoing pages, numbered from 1 to 49 inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Jones & Baker, Alleged Bankrupts; United States, Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 23rd day of June in the year of our Lord One Thousand Nine Hundred and twenty-four and of the Independence of the said United States the One Hundred and forty-eighth.

Wm. Parkin, Clerk. (Seal of United States Circuit Court of Appeals, Second Circuit.)

[fol. 123] In Supreme Court of the United States

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

Order Granting Petition for Certiorari—Filed Oct. 13, 1924

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Second Circuit, and of the argument of counsel thereupon had, as well in support of as against the same, it is now here ordered by this Court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.

In the Supreme Court of the United States

October Term, 1924

United States of America and Frank K. Bowers, Collector of Internal Revenue, Petitioners,

v.

Henry H. Kaufman, Trustee in Bankruptcy of Abraham Finkelstein, Israel Finkelstein, and Nettie Finkelstein, Individually, and as Copartners Trading as Finkelstein Brothers.

No. ——

United States of America and Frank K. Bowers, Collector of Internal Revenue, Petitioners,

v.

Alfred C. Coxe, Jr., Receiver of Jones and Baker, Alleged Bankrupts.

No. ——

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

The Solicitor General, on behalf of the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, prays that a writ of certiorari issue to review

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the decree of the United States Circuit Court of Appeals for the Second Circuit entered on April 14, 1924 (R. 70) (R. 48), affirming in one opinion separate orders in bankruptcy of the District Court for the Southern District of New York in the above two cases (R. 44) (R. 22).

STATEMENT OF THE CASE

Respondent in the first case above is trustee in bankruptcy of Abraham Finkelstein, individually, and Finkelstein Brothers, a partnership, composed of Abraham Finkelstein and two others. Said partnership was engaged in business in New York City as manufacturers and importers of embroidery and dealers in cotton goods. Individual income tax return for the year 1919 was filed by Abraham Finkelstein under Sections 218 (a) and 223 of the Revenue Act of 1918 (40 Stat. 1057, Chap. 18, *infra*). The entire income shown therein was derived from the partnership business and represented salary and undistributed share of the partnership net income for 1919 (R. 23), previously reported under Section 224 of said act. The return was filed March 15, 1920, and at the same time $3,841.10, which was one-quarter of the total tax liability of $15,364.40, was paid. Subsequently the partnership and the partners, individually, went into bankruptcy. The balance of the tax amounting to $11,523.30, plus statutory interest, has not been paid (R. 25), and constitutes the basis of the Government's claim in this case.

Upon examination it was found that Abraham Finkelstein had no separate individual estate. He stated that "all the property that he had in the world had been placed by him in the firm of Finkelstein Brothers" (R. 18). *It is admitted that the total income of Abraham Finkelstein upon which the tax in question is based was derived from the partnership business* and the correctness of the tax is not questioned (R. 23). The partnership assets are much in excess of the tax liability, but are not sufficient to pay all the partnership creditors in full (R. 26).

In the second case above Jones & Baker was a New York stock brokerage firm, now defunct, in which William R. Jones and Jackson B. Sells were the sole partners. On May 31, 1923, the firm, an alleged bankrupt, was placed in the hands of respondent as receiver. In July, 1923, income taxes for 1918, 1919, and 1920 were assessed against Jones (R. 13, 15) and Sells (R. 17, 19) in amounts which on November 26, 1923, were reduced by stipulation to $273,739.07 on the part of Jones (R. 10) and $5,518.41 on the part of Sells (R. 11). On November 23, four months after the assessment and three days prior to the date of said stipulation, an offer of composition in bankruptcy was made by the firm to partnership creditors (R. 6), as distinguished from the creditors of the individual partners. The tax claims are still outstanding. It is admitted that the taxes are correct (R. 10, 11). There are no separate individual estates, and partnership assets are not sufficient to pay all the partnership creditors in full (R. 3). The

same situation is presented in this case as in the Finkelstein case (R. 21, 22).

Claims for the taxes hereinbefore mentioned were filed against the respective partnership estates by Frank K. Bowers, Collector of Internal Revenue, on behalf of the United States. It was contended by the Government that said claims were payable out of the partnership assets prior to the payment of the general partnership creditors, whereas the trustee and receiver contended that the claims were only payable out of separate individual estates. Of such there were admittedly none because the individuals had put it out of their power to pay taxes by placing or leaving all their assets in the partnerships. The District Court for the Southern District of New York disallowed the claims in both cases based upon the referee's ruling in the Finkelstein case, and upon petitions for appeal the Circuit Court of Appeals in a single opinion affirmed the decrees.

QUESTION PRESENTED

Is the United States entitled to be paid out of partnership assets in bankruptcy ahead of general creditors for taxes assessed against the partners based on their distributive shares of partnership income which they have not withdrawn, and where they have placed or left all their personal assets in the partnership so that they have no individual estates out of which to pay the taxes assessed against them?

STATUTES INVOLVED

Section 218(a) of the Revenue Act of 1918 (40 Stat. 1057, Chap. 18) provides:

> That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

Section 224 of the same Act provides:

> That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Section 3466 of the Revised Statutes of the United States provides:

> Whenever any person indebted to the United States is insolvent, or whenever the

> estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

The Bankruptcy Act of July 1, 1898 (30 Stat. 544, Chap. 541, as amended), contains in Section 5 the following subdivisions:

> (f) The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership.
>
> (g) The court may permit the proof of the claim of the partnership estate against the individual estates, and vice versa, and may marshal the assets of the partnership estate

and individual estates so as to prevent preferences and secure the equitable distribution of the property of the several estates.

Section 64 (a) of the Bankruptcy Act provides as follows:

> The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.

REASONS FOR GRANTING THE PETITION

1. The Court erred in holding that the United States was not entitled to be paid out of partnership assets ahead of general creditors of the partnerships.

2. The United States District Court for the District of New Jersey in the *Matter of Brezin & Schaefer* (297 Fed. 300), which presented the same question, sustained the right of the United States to collect the tax. *In re Strassburger* (23 Fed. Cas. No. 13526) and *Lewis* v. *United States* (92 U. S. 618), also support the contention of the Government.

3. The question in issue is of great public importance. Many cases involving large sums of money and presenting the same issue are now pending in various United States courts throughout the country. A review of the question by this court will set at rest

much doubt, avoid multiplicity of suits, and promote the orderly administration and settlement of insolvent and bankrupt partnership estates.

4. The ruling of the court, if allowed to stand, will have far-reaching effect. It opens the door to evasion of taxes and will seriously delay and hamper the collection of the public revenue. Large sums of money are involved.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit should be granted.

James M. Beck,
Solicitor General.

ARGUMENT

I

The United States is entitled to priority in payment of taxes out of the partnership assets

The error in the instant case lies in the assumption by the Court that the Government's position is that the taxes assessed against the partners should be paid out of partnership assets the same as if assessed against the partnership. The Government's contention is quite otherwise. It is not attempting to *tax* the partnership, either directly or by implication, for taxes due from individual members. All the Government is trying to do is to *collect* such tax already assessed out of the partnership assets in which the partner had placed and left his income and other individual assets.

Section 218(a) of the Revenue Act of 1918, *supra*, provides that persons carrying on business in partnership shall be liable only in their individual capacity, but it is important to note that it also expressly provides that they shall be taxed on their shares of the partnership profits "*whether distributed or not.*" Obviously, therefore, if partners place or leave all their separate assets in the partnership the Government can only collect the tax from such partnership assets.

The fact that the partners can be taxed only in their individual capacity is not material when it comes to a question of the collection of the tax. *Collection* is an entirely different matter from *assessment*. Collection may be made from any available fund. It is immaterial that the Government can not distrain directly against the partnership. It is not limited to this remedy alone in the collection of taxes.

For example, a corporation may be dissolved and its assets distributed to its stockholders. A tax may thereafter be assessed against the corporation. Distraint against the stockholders will not lie. Nevertheless the Government can sue and require them to pay the tax to the extent of any assets received, regardless of whether such assets can be traced or whether they have been lost. (*Pierce* v. *United States*, 255 U. S. 398; *United States* v. *Boss & Peake Automobile Co.*, 285 Fed. 410.)

The analogy is close. Here the partnership received and retained the partner's property when the partner was indebted to the Government for taxes. The income to which the partner was entitled was left in the partnership. Finkelstein testified " that all the property he had in the world " he had placed in the partnership. To such extent the partnership estate has been enriched. Clearly, under the trust fund theory above mentioned, the Government is entitled to be paid out of the partnership assets ahead of the general creditors, at least to the extent that individual assets increased the

assets of the partnership. Otherwise the creditors will be enriched at the expense of the Government.

The right of the United States to be paid out of partnership assets ahead of partnership creditors is not controlled by the rule as to marshalling assets in Section 5 (f) of the Bankruptcy Act of 1898, *supra*. This Section relates to *debts* owing *creditors*, and not to *taxes* nor to the *United States*. Taxes are not debts. (*New Jersey* v. *Anderson*, 203 U. S. 483; *Meriwether* v. *Garrett*, 102 U. S. 472.) Section 5 (f) limits rights and privileges. The United States is not mentioned therein. Consequently it is not bound. It is well settled that the United States is not bound by such statutes unless expressly named. (*United States* v. *Dalles, etc., Company*, 140 U. S. 599, 632; *Gibson* v. *Chouteau*, 13 Wall. 92, 99.)

In *Lewis* v. *United States* (92 U. S. 618) a claim of the United States against an English partnership was involved. This Court passed completely over the English partnership to an associated American partnership with some, but not all, of the same partners, and held that the United States was entitled to be paid out of the individual estates of American partners ahead of the creditors of the individual partners. It was held that the rule as to marshalling assets did not apply. The decision and reasoning of the Court in that case clearly cover the converse situation with which we are here confronted.

In the case of *In re Strassburger* (23 Fed. Cas. No. 13526) the court held that the United States was

not bound by the general bankruptcy rule for marshalling assets and that it was entitled to be paid first out of partnership assets on account of the individual indebtedness to it of the partners, and that its interest in the partnership assets was not limited merely to the interest of the partners after payment of the partnership debts.

The Government contends that the correct principle for the solution of the question in the cases at bar is to be found in the *Matter of Brezin & Schaefer* (297 Fed. 300 (D. C. N. J.), decided January 25, 1924), in which similar facts and the same question were involved. There Walter Brezin and Hugo Schaefer were partners trading as Brezin & Schaefer. They were adjudicated bankrupt both individually and as partners. The United States filed a priority claim for taxes against the partnership estate for taxes assessed against the partners individually, but based on partnership income. It was objected that the claims were invalid against the partnership estate, and that there were no assets in the individual estates. The testimony showed that the partners left a considerable portion of the net profits of the partnership business undistributed. The court held that the United States could collect. It said in part (p. 304 et seq.):

> There is no dispute but that, on these various days, there were actual funds in being, voluntarily left by Brezin and Schaefer among the partnership moneys, and which, if they had been claimed by the partners as individuals—as with perfect propriety they could

have been claimed under the articles of copartnership—would have more than sufficed to put the individuals in possession of resources out of which these taxes could have been paid and satisfied. Has the refusal or neglect of the partners to claim their individual rights from time to time, their election to leave their respective personal moneys in their business enterprise, so changed the character of those moneys, so undermined the government's claim, as practically to nullify it, and, at the same time, put in possession of the Trustee, for the benefit of partnership creditors, many thousands of dollars which, as the result of the partners' mere election, are listed as partnership funds; whereas, they were actually, at all times throughout the period herein involved, individual funds, even though unclaimed? I believe not, * * *

It should be borne in mind that this proceeding is not designed to tax the partnership for taxes due from the individuals, and therefore runs in nowise counter to the Revenue Acts of 1917 and of 1918. The taxes herein have been assessed against the individuals, and all that is now sought is an available and proper fund out of which to collect the same, as so assessed.

The government's claim for taxes is not to be classed with a creditor's claim for the payment of an ordinary debt, for "taxes are not debts, but imposts levied for the support of the government." * * *

Therefore, in my opinion, the government's claim, being in the nature of an equitable

> lien, has followed the property into the hands of the Trustee in Bankruptcy, where it awaits satisfaction. * * *
>
> Inasmuch as the undistributed profits in a partnership are to be used, so far as they extend, as the basis for the computation of an individual income tax, a partner possessed of such profits certainly has a taxable income; and such income, even in the guise of partnership funds, is available for collection, as well as computation, purposes.

The cases relied on by the Circuit Court of Appeals, such as *United States* v. *Hack* (8 Peters, 271) and *United States* v. *Evans* (25 Fed. Cas. No. 15062), are readily distinguishable from the cases at bar. They relate specifically to *debts* and *creditors*. Here we are dealing with *taxes* and the *United States*. Moreover, the *debts* in such cases did not arise out of partnership transactions, but were separate obligations of the individuals unconnected with any partnership transactions.

There is a wide difference between cases (1) where a partner incurs separate *debts* of his own unconnected with the business of the partnership of which he is a member and cases (2) where a partner incurs a liability based on a partnership transaction, or, as in the cases at bar, a *tax* liability based on partnership profits which are left in the business.

It is clear from Sections 218 (a) and 224 of the Revenue Act of 1918, *supra*, that Congress never intended that the undistributed income of a part-

nership should go free of tax. Simply because the *tax* is not assessable against a partnership as such, it by no means follows that *collection* may not be had out of partnership assets ahead of partnership creditors.

CONCLUSION

In view of the large number of cases involving the same question now pending throughout the United States, and the fact that the decision if allowed to stand will result in evasion of taxes and seriously interfere with the proper administration of the revenue laws, it is respectfully submitted that the petition for certiorari should be granted in this case.

James M. Beck,
Solicitor General.
Mabel Walker Willebrandt,
Assistant Attorney General.
Sewall Key,
Attorney.

July, 1924.

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AUTHORITIES

In the Supreme Court of the United States

OCTOBER TERM, 1924

UNITED STATES OF AMERICA AND FRANK K. Bowers, Collector of Internal Revenue, petitioners *v.* HENRY H. KAUFMAN, TRUSTEE IN BANKRUPTCY of Abraham Finkelstein, Israel Finkelstein, and Nettie Finkelstein, Individually, and as Copartners Trading as Finkelstein Brothers	No. 515

UNITED STATES OF AMERICA AND FRANK K. Bowers, Collector of Internal Revenue, petitioners *v.* ALFRED C. COXE, JR., RECEIVER OF JONES and Baker, Alleged Bankrupts	No. 516

ON CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

STATEMENT OF THE CASE

Respondent in the first of the above-entitled cases is trustee in bankruptcy of Abraham Finkelstein, individually, and of Finkelstein Brothers, a

partnership, composed of Abraham Finkelstein and two others. Said partnership was engaged in business in New York City as manufacturers and importers of embroidery and dealers in cotton goods. An individual income tax return for the year 1919 was filed by Abraham Finkelstein under Sections 218 (a) and 223 of the Revenue Act of 1918. The entire income shown therein was derived from the partnership business and represented salary and the undistributed share of the partnerhip net income for 1919, previously reported under Section 224 of said act. The return was filed March 15, 1920, and at the same time $3,841.10, which was one-quarter of the total tax liability of $15,364.40, was paid. Subsequently the partnership and the partners, individually, went into bankruptcy. The balance of the tax, amounting to $11,523.30, plus statutory interest, has not been paid, and constitutes the basis of the Government's claim in this case.

Upon examination it was found that Abraham Finkelstein had no separate individual estate. *It is admitted that the total income of Abraham Finkelstein upon which the tax in question is based was derived from the partnership business* and the correctness of the tax is not questioned. The partnership assets are much in excess of the tax liability, but are not sufficient to pay all the partnership creditors in full.

In the second case Jones & Baker was a New York stock brokerage firm, now defunct, in which

William R. Jones and Jackson B. Sells were the sole partners. On May 31, 1923, the firm, an alleged bankrupt, was placed in the hands of respondent as receiver. In July, 1923, income taxes for 1918, 1919, and 1920 were assessed against Jones and Sells in amounts which on November 26, 1923, were reduced by stipulation to $273,-739.07 on the part of Jones and $5,518.41 on the part of Sells. On November 23, four months after the assessment and three days prior to the date of said stipulation, an offer of composition in bankruptcy was made by the firm to partnership creditors, as distinguished from the creditors of the individual partners. The tax claims are still outstanding. It is admitted that the taxes are correct. There are no separate individual estates, and partnership assets are not sufficient to pay all the partnership creditors in full. The same situation is presented in this case as in the Finkelstein case.

Claims for the taxes hereinbefore mentioned were filed against the respective partnership estates by Frank K. Bowers, Collector of Internal Revenue, on behalf of the United States. It was contended by the Government that said claims were payable out of the partnership assets prior to the payment of the general partnership creditors, whereas the trustee and receiver contended that the claims were only payable out of separate individual estates. Of such there were admittedly none, because the individuals had put it out of

their power to pay taxes by placing or leaving all their assets in the partnerships. The District Court for the Southern District of New York disallowed the claims in both cases based upon the referee's ruling in the Finkelstein case, and upon petitions for appeal the Circuit Court of Appeals in a single opinion affirmed the decrees. The cases come here on certiorari to the Circuit Court of Appeals.

The following are the statutes which are involved in these cases:

> Section 218(a) of the Revenue Act of 1918 (40 Stat. 1057, Chap. 18), which provides:
>
> "That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting pèriod of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed."
>
> Section 224 of the same Act, which provides:

"That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

Section 3466 of the Revised Statutes of the United States, which provides:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

The Bankruptcy Act of July 1, 1898 (30 Stat. 544, Chap. 541, as amended), containing in Section 5 the following subdivisions:

"(f) The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each

partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership.

"(g) The court may permit the proof of the claim of the partnership estate against the individual estates, and vice versa, and may marshall the assets of the partnership estate and individual estates so as to prevent preferences and secure the equitable distribution of the property of the several estates."

Section 64 (a) of the Bankruptcy Act, which provides:

"The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court."

The single question presented may be stated as follows:

Is the United States entitled to be paid out of partnership assets in bankruptcy ahead of general creditors for taxes assessed against the partners based on their distributive shares of partnership income which they have not withdrawn, and where they have placed or left all their personal assets in the partnership so that they have no individual estates out of which to pay the taxes assessed against them?

ARGUMENT

It is the contention of the United States in these cases that the question presented, as it is above stated, should be answered in the affirmative; that, to be specific, and referring to the Finkelstein case for illustration, as we shall throughout this argument, the United States is entitled to be paid out of the assets of Finkelstein Brothers and ahead of partnership creditors the $11,523.30 still due from Abraham Finkelstein as a tax upon income derived solely from the partnership and by him left in the partnership and constituting a part of its assets.

Obviously the contention which we thus make must fail unless we can reconcile it with subdivision (f) of Section 5 of the Bankruptcy Act of July 1, 1898, set out in full above, requiring in substance that the proceeds of partnership property shall be appropriated to the payment of partnership debts ahead of the debts of the individual partners. It

is upon that provision that respondents rely and that the court below based its decision.

I

The provision referred to does not defeat the claim of the United States for the reason that *the United States has a lien or priority in the nature thereof as to the taxes due it giving it precedence over general partnership creditors.*

Such was the precise holding of Runyon, District Judge, in the *Matter of Brezin & Schaefer* (297 Fed. 300 (D. C. N. J.), decided January 25, 1924), in which similar facts and the same question were involved. There Walter Brezin and Hugo Schaefer were partners trading as Brezin & Schaefer. They were adjudicated bankrupt both individually and as partners. The United States filed a priority claim for taxes against the partnership estate for taxes assessed against the partners individually, but based on partnership income. It was objected that the claims were invalid against the partnership estate, and that there were no assets in the individual estates. The testimony showed that the partners left a considerable portion of the net profits of the partnership business undistributed. The court held that the United States could collect. It said in part (p. 304 et seq.):

> There is no dispute but that, on these various days, there were actual funds in being, voluntarily left by Brezin and

Schaefer among the partnership moneys, and which, if they had been claimed by the partners as individuals—as with perfect propriety they could have been claimed under the articles of copartnership—would have more than sufficed to put the individuals in possession of resources out of which these taxes could have been paid and satisfied. Has the refusal or neglect of the partners to claim their individual rights from time to time, their election to leave their respective personal moneys in their business enterprise, so changed the character of those moneys, so undermined the government's claim, as practically to nullify it, and, at the same time, put in possession of the Trustee, for the benefit of partnership creditors, many thousands of dollars which, as the result of the partners' mere election, are listed as partnership funds; whereas, they were actually, at all times throughout the period herein involved, individual funds even though unclaimed? I believe not. * * *

It should be borne in mind that this proceeding is not designed to tax the partnership for taxes due from the individuals, and therefore runs in no wise counter to the Revenue Acts of 1917 and of 1918. The taxes herein have been assessed against the individuals, and all that is now sought is an available and proper fund out of which to collect the same as so assessed.

The government's claim for taxes is not to be classed with a creditor's claim for the

> payment of an ordinary debt, for " taxes are not debts, but imposts levied for the support of the government." * * *
>
> Therefore, in my opinion, the Government's claim, being in the nature of an equitable lien, has followed the property into the hands of the Trustee in Bankruptcy, where it awaits satisfaction. * * *
>
> Inasmuch as the undistributed profits in a partnership are to be used, so far as they extend, as the basis for the computation of an individual income tax, a partner possessed of such profits certainly has a taxable income; and such income, even in the guise of partnership funds, is available for collection as well as computation purposes.

The entire opinion of Judge Runyon in the *Matter of Brezin & Schaefer* is set out in the appendix to this brief.

The right to priority of payment here claimed and recognized under like circumstances in the *Matter of Brezin & Schaefer* arises from the following provisions of the statutes read in connection and considered together with that section (subdivision (f) of Section 5 of the Bankruptcy Act of July 1, 1898) whereon respondents rely:

First. That part of Section 218 (a) of the Revenue Act of 1918 (40 Stat. 1057, Chap. 18) which provides that the individual partner shall be liable for income tax computed on his distributive share of the net income of the partnership, *whether distributed or not.*

Second. Section 3186 of the Revised Statutes of the United States (37 Stat. 1016), as amended, which provides that—

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *

Third. That part of Section 3466 which gives priority in case of insolvency to the debts of the United States.

Fourth. That part of Section 64 (a) of the Bankruptcy Act which provides that out of the estate of a bankrupt taxes due the United States and other governmental units shall be paid in advance of the claims of creditors.

The right to priority in payment out of the assets of the partnership, under the circumstances of these cases, whether it be called a legal lien, an equitable charge, or a right of priority in the nature of an equitable lien, we submit is clearly contemplated by these various provisions of the statutes. Certainly, Congress did not intend that a partner by his own acts should place rights to property or income beyond the reach of the taxing authorities and thereby deprive the government of tax in violation of the plain intent of all the law.

Adjudication in bankruptcy in the Finkelstein case took place April 1, 1921, long before which date the government had obtained a legal lien on Abraham Finkelstein's property and rights to property to secure the payment of the income tax assessed against him by reason of income derived solely from the partnership and left by him in the partnership. For the purpose of assessment that income, although undistributed, although at all times a part of the assets of the partnership, was treated by the law as the property of the partner, as his gain, his income. If his property for that purpose, that is to say, for the purpose of assessment, certainly it should also be regarded as his property within the meaning of the statute creating a lien in favor of the government upon all property or rights to property belonging to the tax debtor, and that notwithstanding the general doctrine of the law of partnership that the partner's only right to property in the assets of the partnership is his equity to share in the partnership estate after the payment of partnership creditors.

The lien for taxes having attached before bankruptcy and Abraham Finkelstein having placed and left all his property in the partnership, the lien ran to this property for an amount far in excess of the tax liability. The tax liability was \$11,523.30. Abraham Finkelstein's distributive share of the partnership income for 1919, left by him in the partnership, was \$59,440.99. The part-

nership creditors had only general unsecured claims. With its lien, therfore, the government has a legal right to prior payment ahead of the partnership creditors.

But aside from its legal lien and the legal rights derived therefrom, the government has a claim which constitutes an equitable charge upon the partnership estate superior to any rights of the partnership creditors. The partnership estate was unduly and therefore unjustly enriched by enhancement from the property of the individual partner, and in fairness and equity must account for the increase.

The United States has a valid claim against the partnership estate for taxes due and owing to it by reason of the merger of Abraham Finkelstein's property with the partnership assets, and its right of priority in payment thereof (here to satisfaction by the partnership estate of the legal and equitable charge upon it) applies equally whether the debt be of an equitable or legal nature. (*U. S.* v. *Barnes*, 31 Fed., 705; *Howe* v. *Sheppard*, 12 Fed. Cas. No. 6,772.)

It goes without saying that the trustee in bankruptcy takes the assets of the bankrupt estate subject to all *bona fide* liens, legal and equitable against it. (Section 67 of the Bankruptcy Act.) For this purpose he stands in the shoes of the bankrupt. The lien provisions of the Federal Statutes (Sec. 3186, U. S. R. S.) are not affected by the Bankruptcy Act (Sec. 67), and the prior-

ity provisions (Secs. 3466 and 3467, U. S. R. S.) are in *pari materia* with the Bankruptcy Act (Trust Co. v. Surety Co., 224 U. S. 152), and give the United States a right to priority in payment which persists against a bankrupt estate, so that the person becoming possessed of the bankrupt's assets is made a trustee for the United States and is bound to pay its claim first out of the bankrupt's estate.

This priority must be satisfied out of any available fund, and the partnership estate constitutes such a fund in this case since it is charged with a lien for the payment of taxes due from Abraham Finkelstein, he having merged his own estate in the partnership estate. The United States has a legal and equitable claim against the entire partnership assets for the prior payment of its taxes, such claim arising from the partner's interest being left therein. The partnership estate was swelled abnormally by the undistributed income and other assets of Abraham Finkelstein which should have paid the tax in the year when it was due.

The United States, however, does not need an express lien on the assets existing at the time they passed into the trustee's hands in order to succeed in this case, for it had a priority right to payment from the time the taxes became due, and this right extended to the partnership assets by reason of the property which Abraham Finkelstein had placed

or left therein. In *Marshall* v. *New York*, 254 U. S. 380 at 386, Mr. Justice Brandeis said:

> The right of priority has been likened to an equitable lien. *State* v. *Rowse*, 49 Missouri, 586, 592. The analogous preference in payment to claims for labor by state statutes, and to which the Bankruptcy Act gives priority, have been described as being "tantamount" to a lien. *In re Laird*, 109 Fed. Rep. 550, 555; *In re Bennett*, 153 Fed. Rep., 673, 677. The priority is a lien in the broad sense of that term which includes "those preferred or privileged claims given by statute or by admiralty law."

And in *Ruling Case Law*, Vol. 26, Sec. 348, it is said that even where there is not an actual legal lien, yet the right of priority of payment of taxes constitutes in its own nature an *equitable lien* on the taxpayer's property, and that property in the course of administration under the Bankruptcy Act is not freed from liens or claims for taxes.

Section 3466 of the Revised Statutes gives the United States a right of priority in payment of its claims which is upon the authorities cited the equivalent to a lien. Since the tax in this case became due before bankruptcy, the "equitable lien" extended to Abraham Finkelstein's partnership property and could only be satisfied by payment. This would be true even though there were no legal lien or the still more important equitable charge which rests upon the partnership assets.

As stated in the Marshall case, the priority or lien extends to the debtor's property whether in his own possession or that of a third person or in *custodia legis*.

It follows, of course, that the existence either of a legal lien, equitable charge, or equitable lien in favor of the United States and attaching to the partnership assets removes the claim of the United States from any effect of subdivision (f) of Section 5 of the Bankruptcy Act, even if that provision of the law might otherwise preclude priority in favor of the United States.

II

The rights of the partnership creditors, being derivative through the partners, are postponed to the superior right and equity of the United States

Whatever equity the partnership creditors have under the doctrine as to marshalling assets is a derivative one, not held or enforceable in their own right. It is practically a subrogation to the equity of the individual partner, to be made effective only through him. Hence, if he is not in a position to enforce it, the creditors of the firm can not be. (*Case* v. *Beauregard*, 99 U. S. 119; *Rive* v. *Barnard et al.*, 20 Vt. 476; *Appeal of the York County Bank*, 32 Pa. St. 446.)

In the case of *Schmidlapp* v. *Currie*, 55 Miss. 597, the Court said that the doctrine as to marshalling assets was only a principle of administration adopted by the courts in winding up a business, and

that the principle "springs alone out of the obligation to do justice between the partners."

If the principle as to marshalling assets springs out of the obligation to do justice between the partners, it becomes pertinent to inquire what the obligation is here; whether there is any equity as between the partners that partnership creditors shall be paid before the outstanding tax; and whether any derivative equity arises in the creditors where undisturbed income on which the tax has not been paid has swelled the partnership assets. The government has a prior equity and this equity constitutes an equitable charge upon the partnership assets over and above its lien. The partnership assets are a fund for the liquidation of the outstanding tax liability, and the obligation between the partners is that the benefited estate shall pay the tax.

Creditors transact business subject to tax claims of all kinds, and with constructive knowledge thereof, and this is true whether the claims constitute an equitable or legal lien upon the assets to which the creditors look for payment of their debts. The trustee stands in the shoes of the bankrupt, merely taking the assets with such a status as to protect his possession which, however, is subject to all bona fide liens, legal or equitable. The creditors here are common creditors without liens or priority, and they have no right to the assets until prior legal and equitable claims and charges against these assets are paid. As the creditors of the partnership are general debt

creditors and have no preferred status, they can not stand on a parity with the United States.

The liens of the government, legal and equitable, would have been valid as against the creditors of the partnership before bankruptcy, and therefore they are valid as against the estate in the Trustee's hands. Such liens are in no way abrogated or adversely affected by the Bankruptcy Act. (Section 67 of the Bankruptcy Act of 1898, as amended.)

In *Titus* v. *Maxwell, Trustee of Hamden,* 281 Fed. 433 (6th C. C. A.), decided July 14, 1922, one partner sold his interest in the partnership to the other partner and took notes secured by a chattel mortgage on all the partnership assets. The latter went into bankruptcy shortly thereafter without the notes having been paid and his trustee filed a petition to discharge the proceeds of sale of the assets from the lien of the mortgage, basing his rights upon the proposition that, the partnership having been in debt when the chattel mortgage was given, its creditors must be paid in full before the partnership property or assets could be diverted into any other channel. On appeal the Circuit Court of Appeals reversed the District Court (which had denied the right of the assignee of the vendor partner to share in the assets until after the claims of the partnership creditors were paid in full) and said, after referring to the general equity rule respecting the

marshalling of assets and its application to bankruptcy by Section 5(f) of the Bankruptcy Act:

> "It was long since declared to be the rule in equity that the right of partnership creditors to appropriate the partnership property specifically to the payment of their debts is derived, not through specific lien, but by a sort of subrogation through the partner whose original right it was to have the partnership assets applied to the payment of partnership obligations; that this equity of the partnership creditors subsists so long, and so long only, as that of the partner through whom the equity is derived remains," and thereafter "the equities of the partners are extinguished, and consequently the derivative equities of the creditors are at an end."

The court was correct in finding in favor of the creditor of the individual bankrupt in preference to the creditors of the partnership because of such creditor's superior right or equity, notwithstanding it at the same time affirmed the general equity rule as to marshalling assets. In this connection it should be noted that the lien of the creditor of the individual bankrupt was allowed as to *all* the partnership assets.

The conclusion is irresistible that Abraham Finkelstein (who had placed all the property that he had in the world in the partnership, included in which was the very income on which the unpaid taxes in question were based and assessed, and with

respect to which the Government has both a lien and an equitable charge which it asserts are of an even higher nature than the lien of the preferred creditor in *Titus* v. *Maxwell*) had and has no right to have the partnership assets applied to the payment of claims of partnership creditors before satisfaction of the taxes due the United States.

As a legal and equitable lienor with a claim for taxes which has priority over the general claims of the partnership creditors, the United States is entitled to be paid first out of the assets of the partnership estate.

Bankruptcy does not affect such right of priority, since the United States is not named in, nor bound by, the section and rule (5f) as to the marshalling of assets; and even if it were, the equitable charge upon the partnership assets for the payment of the outstanding tax would entitle the Government to be paid first.

III

The right of the United States to priority in payment for taxes is not controlled by the general rule of partnership law as to marshalling assets

It is a well-established principle that in the application and interpretation of statutes the sovereign is not to be held bound by a law in which it is not specifically named. This rule is an extension of the English doctrine to the same effect, and has formed part of the American system of jurisprudence from its beginning. In the first

volume of *Kent's Commentaries on American Law* (3d Ed.), 460, it said:

> It is likewise a general rule, in the interpretation of statutes limiting rights and interests, not to construe them to embrace the sovereign power or government, unless the same be expressly named therein, or intimated by necessary implication.

In the case of *In re Strassburger et al.*, 23 Fed. Cas. No. 13,526 (4 Woods, 557), the Court said:

> The Bankruptcy law (Rev. St., Sec. 5121; 14 Stat. 534) prescribes a marshalling of assets between partnership and individual creditors. But it has been held in several cases that the bankrupt law is not binding on the United States. *U. S.* v. *Herron,* 20 Wall. (87 U. S.), 251; *U. S.* v. *The Rob Roy* (Case No. 16,179), *The earlier act of 1797* (Rev. St. Sec. 3466; 1 Stat. 515), gives to the United States priority over all other creditors in cases of the bankruptcy or insolvency of any person or persons indebted to it, and the bankrupt act recognizes this preference by making debts due to the United States the first in order to be paid out of the Bankrupt's estate, after paying the fees, costs, and expenses. Rev. St., Sec. 5101 (14 Stat. 530).

Although the Bankruptcy Act of 1867 was referred to in this case, yet the present act is in all respects the same on the point of marshalling assets, and the same rule applies. Neither Section 5(f) of the present Act nor Section 36 of the Act

of 1867 mention the United States as a creditor against whom assets may be marshalled so as to deprive it of any rights which it may have in the collection of its taxes, and they are not applicable to the Government under the circumstances of this case. Taxation is one of the high and indispencsible attributes of sovereignty, and the Government's right of priority over other creditors is enlarged rather than limited by any provision of the bankruptcy laws. (See *Marshall* v. *People*, 254 U. S. 380.)

In the case of *Lewis* v. *United States*, 92 U. S. 618, counsel for the trustee of several bankrupt estates directly raised the question of the marshalling of assets, and the court specifically held that the United States was not bound by that rule, and further that the priority given the United States for the payment of its claims by the Bankrupt Law (to wit, that taxes and debts shall be paid first) and by the Statute of 1797 (Section 3466 of the Revised Statutes of the United States) to wit, that where there is a debt and bankruptcy, the United States shall have priority of payment, superseded the rule in equity recognized by the Bankruptcy Act, namely, that partnership property is to be first applied in payment of the partnership debts, and individual property in payment of the individual debts. It said that neither statute (Bankrupt Law or Act of 1797) contained any qualification, and that it could interpolate none.

In the decision of this case in the Circuit Court, 22 Int. Rev. Rec., 39, affirmed by the United States Supreme Court, the Court said:

> "How can a claim preferred by an Act of Congress absolutely, without exception or qualification, be postponed to the claims of other creditors by force of an equitable maxim never intended to be applicable to the case of a claimant who has a superior right by law?" "The right to priority of payment is a legal right, not a merely equitable one. It is called into existence by the bankruptcy of the debtors, but it is not created by the bankrupt law."

In the case of *In re Strassburger et al.*, 23 Fed. Cas., 13,526, the Court said:

> The government is not bound by the general equity rule for marshalling assets, nor by the rule prescribed by the bankrupt act in conformity thereto, any further than as that rule is founded in the particular case on the lien of the several parties *inter sese*.

The lien of the government for taxes is superior to the lien which partners might have under other circumstances to have the partnership funds used first for the payment of partnership debts. The United States has a preference given by law, and Abraham Finkelstein having placed all his property in the partnership estate, the partnership property is liable for the payment of the tax indebtedness, and the partnership creditors must be postponed and take subsequent to the rights of the United States.

In the *Strassburger* case two bankrupt partners (one as principal and the other as surety) were indebted to the United States for internal revenue taxes on distilled spirits, a judgment having been obtained against them and another surety between the time of the filing of the petition in bankruptcy and adjudication, and the Court held that neither partner had a lien on the partnership assets for the payment of partnership debts before the payment of their individual indebtedness to the government, and that the rights of the creditors being derivative were postponed. It was said that an execution against both partners would be leviable on the corpus of the partnership property, and *not merely on the interest of the partners after payment of the partnership debts*, and further that although equity in ordinary cases and under other circumstances might marshal assets according to the usual doctrine, *yet the United States was not subject to such equities.*

After holding as it did, the Court made the following very important observation:

> This view renders it unnecessary to examine the question of the admissibility of parol evidence to show that *the distilling on which the tax arose was really carried on by the partnership.* (Italics ours.)

Had there been occasion to consider this last point the Court would undoubtedly have reached the same result and found in favor of the United States regardless of any question of equities as between the partners.

The same is true in the Finkelstein case. *The income by which the tax was measured, and on which it was based and assessed, was that of the partnership obtained through the conduct of the partnership business, and was in no sense a tax on individual income of the partners secured through individual channels and apart from the partnership business.* (Transcript of Record, Stipulation, page 12.)

Furthermore, the law provides that the Court may marshall the assets of the partnership estate and individual estates *so as to secure the equitable distribution of the property of the several estates.* (Section 5g of the Bankruptcy Act.) This provision could have no effective meaning unless it were contemplated that situations might arise which would furnish exceptions to the general rule as to marshalling assets.

Moreover, Section 5(f) of the Bankruptcy Act concerning the marshalling of assets does not mention or refer to the United States or taxes in any way. It refers to *debts* owing *creditors,* not to *taxes* or the *United States. Taxes are not debts* but " imposts or demands levied for the support of the Government," *and are of a higher nature than debts* (*New Jersey* v. *Anderson,* 203 U. S. 483; *Meriwether* v. *Garrett,* 102 U. S. 472; *Lane County* v. *Oregon,* 7 Wall. 71; *United States* v. *Proctor,* 286 Fed. 272, decided in 1923), and the government's priority can not be affected except by express words

to that effect (*United States* v. *Herron,* 20 Wall. 251.)

Section 5(f) of the Bankruptcy Act limits rights and privileges. Therefore it is not binding on the Government, since it is well settled that the United States is not bound where not expressly named. (*Lindsey* v. *Miller,* 8 Pet. 666; ***Gibson* v. *Chouteau,*** 13 Wall. 99; ***United States* v. *Dalles, etc., Co.,*** 140 U. S. 632.)

IV

Conclusion

For the reasons hereinbefore set out we urge that in the Finkelstein case the United States is entitled to priority in payment out of the partnership assets. The same reasoning applies to the second case, No. 516, *United States et al.* v. *Coxe, Receiver of Jones and Baker, etc.* The two cases were submitted below upon the theory that the facts were the same. Substantially, the facts are identical and the cases were so treated below and are so treated herein, although it should be pointed out that in the second case it was not specifically proved or admitted that the individual income taxed was solely derived from the partnership business. (See stipulation at page 45 of the Record.)

Respectfully submitted.

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Special Assistant to the Attorney General.

January, 1925.

APPENDIX

Opinion of the United States District Court for the District of New Jersey in the *Matter of Brezin & Schaefer* (297 Fed. 300), presenting the same question as that involved here.

OPINION

RUNYON, District Judge: The essential facts herein are as follows: Walter Brezin and Hugo Schaefer were partners trading as Brezin & Schaefer, and engaged in silk manufacture in Paterson, N. J., during the years 1917, 1918, 1919, and a portion of 1920.

In December, 1920, as the result of an involuntary petition filed against said partners, both as individuals and as partners, they were adjudicated bankrupts. On April 28, 1922, Frank C. Ferguson, collector of internal revenue for the Fifth District of New Jersey, filed a proof of claim with the referee in bankruptcy for taxes claimed to be due from the bankrupts to the United States. Thereafter, on May 31, 1922, he filed another claim for additional and further taxes, and on September 21, 1922, still another amended and corrected proof of claim for the sum total of the two prior claims. This claim, in short, was as follows: Against Brezin & Schaefer, additional taxes for the fiscal year ending June 30, 1917, and the ensuing period ending January 1, 1918, aggregating $1,232.01; against Walter Brezin, unpaid and additional taxes for the years 1917,

1918, and 1919, aggregating $6,865.62; and against Hugo Schaefer for like items and for the same period, aggregating $6,836.34.

In each of said claims preference and priority of payment was claimed under sections 3466 and 3467 of the United States Revised Statutes (Comp. St. §§ 6372, 6373) and section 64a of the Bankruptcy Act of 1898 (Comp. St. § 9648).

Within a month thereafter, the trustee for the bankrupts filed a petition setting forth his objections to the final proof of claim, as follows: (a) That the claim was not filed within one year, as limited by the Bankruptcy Act. (b) That no claim was filed by the United States in this court within one year from the date of adjudication. (c) That the claim does not set forth facts constituting any valid claim by the United States against the estate of the said bankrupts or the trustee thereof, or the assets of property belonging to the estate, either as individuals or as partners. (d and e) That neither partner individually nor the partnership did or does owe the United States taxes for the fiscal years ending June 30, 1917 and 1918, respectively. (f) That Walter Brezin did not and does not owe taxes to the United States for 1917, 1918, 1919, or any part thereof. (g) The same as next hereinabove as to Hugo Schaefer. (h and i) That no assets of any kind belonging to the individual partners came into possession of the trustee in bankruptcy.

The petitioner then prayed for an order disallowing and rejecting the claim of the United States and for further relief.

An order to show cause, issued by and returnable before the referee in bankruptcy next ensued,

and, as a result of the hearing had before him, the referee made an order reciting that the claim as against the partnership, amounting to $1,232.01, should be allowed; that all the assets which came into the trustee's possession were assets of the partnership, except $1,000 realized from the individual estate of Hugo Schaefer; that the partnership assets are not liable for the payment of taxes owed by the individual partners; and that neither of the individual partners had any taxable income for the years 1917, 1918, and 1919, which could form the basis for the imposition of a tax claim against them as individuals.

The referee then ordered that the claim of the United States in said sum of $1,232.01 be allowed with interest, that the said claim in all other respects be disallowed, and the trustee instructed that the same does not constitute a claim against the estate in his hands.

The United States thereupon filed its petition for review, claiming that the referee erred in two particulars, viz: (1) In finding that the partnership assets are not liable for the payment of taxes owed by the individual partners. (2) That neither of the individual partners had any taxable income for the years stated above which could form the basis of a tax claim against them; and praying that the order be reviewed and reversed, so far as it disallows the claim of the United States and instructs the trustee that said claim does not constitute a claim against the estate in his hands.

The taxes claimed from the partnership were the additional excess profits taxes for the fiscal year ending June 30, 1917, and the additional half year, ending January 1, 1918. These amounted to

$1,232.01, and, as neither party hereto has objected to that portion of the referee's order which provides for the payment thereof, we are in nowise concerned therewith.

(1) Although not certified to this court for review, the fact that the trustee largely emphasizes the point in his argument makes the first matter calling for consideration the question as to whether or not the United States is barred from pressing its claim, not having filed the same within one year from the date of adjudication. The trustee relies upon section 57n of the Bankruptcy Act, and upon the *Anderson Case* (C. C. A.) 279 Fed. 525, in support of his contention.

The language of section 57n (Comp. St. § 9641) is in part, as follows:

> Claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication. * * *

While in the *Anderson Case* the court, among other things, said:

> The United States must file its claim for taxes as any other creditor, if it desires to share in the estate, and the court must determine any question arising as to the amount or legality of such tax.

The question of limiting the time of the United States for the filing of claims has been many times presented to the courts for decision and the general trend of opinion has been to the effect that the government is not bound as are ordinary creditors. *In re Price & Walter* (D. C.), 131 Fed. 546; *In re Fisher & Co.* (D. C.), 148 Fed. 907.

The *Anderson Case,* while seeming to hold to the contrary, really goes no further than to rule that the Government cannot, after notice, indefinitely refuse to present its claim. More than two years had elapsed after adjudication of bankruptcy in this case, and the trustee, desirous of settling the estate, prayed for—

> an order barring and foreclosing the United States from participating in the estate herein, or in the alternative that the United States be directed to file its claim or claims with the referee herein on or before a day certain, in order that the trustee may object thereto and hearings had on said claim in accordance with law.

The United States appeared specially and apparently was satisfied to move a dismissal of the trustee's petition on the ground that the court was without jurisdiction and that service upon the collector of internal revenue was not service upon the United States. These objections being overruled by the referee, testimony was taken on behalf of the trustee, and an order entered barring the United States from participating in the estate for any income tax for the year 1917. The District Court affirmed the referee's order and the Circuit Court of Appeals, after quoting section 64a of the Bankruptcy Act, and calling attention to the fact that it constitutes " a departure from the principles of public policy theretofore prevailing as to the rights of the sovereign which were recognized in the previous acts of 1800, 1841, and 1867," quotes in support of that conclusion, and as defining the scope thereof, the language of

the Circuit Court of Appeals in the case of *In re General Film Corp.*, 274 Fed. 903, as follows:

> We regard this section (64a) as binding on the government because it is named therein and, while conferring priority, as giving the bankruptcy court the power to hear and determine any question that arises as to the amount or legality of a tax assessed by it. The provision applies to taxes of all the persons mentioned, and we could not differentiate the government from the other persons in the absence of language justifying it.

The Anderson opinion then goes on to say:

> The United States must file its claim for taxes as any other creditor, if it desires to share in the estate, and the court must determine any question arising as to the amount or legality of such tax. It can not stand by, as it did here, after permission having been granted to file its claim, and expect to subsequently collect the tax from the bankrupt or his trustee. To permit such a procedure would make it impossible to say when there could be a winding up of the bankruptcy proceedings and a distribution of the assets.

The departure in public policy above noted consists in giving the federal courts jurisdiction as to the amount of legality of any tax, and apparently putting the United States on a par with other taxing divisions. Section 74a expressly recognizes priority and is silent as to any limitation of time, simply making it mandatory that the courts shall order the payment of taxes in advance of payments to creditors.

While it makes a distinct departure from the provisions of section 28, subd. 5, of the previous act (14 Stat. 531) which says " that nothing contained in this act shall interfere with the assessment and collection of taxes by the authority of the United States or any state," it encroaches in no wise upon the authority of section 57n of the Bankruptcy Act, which states that " claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication, * * *" and as this section fails to name the United States in any way, it follows that there is applicable thereto the well-established principle that a sovereign can not be bound by a statute of limitations in which it is not named.

As to ~~the~~ exemption of the United States from the limitation of time, see *In re Stoever* (D. C.) 127 Fed. 394; *In re Cleanfast Hosiery Co.*, 4 Am. Bankr. Rep. 702 (Re. N. Y.); *In re Prince & Walter* (D. C.), 131 Fed. 546; *In re Fisher & Co.* (D. C.), 148 Fed. 907.

In the case of *United States* v. *Birmingham Trust & Savings Co.*, 258 Fed. 562, 169 C. C. A. 502, the Circuit Court of Appeals for the Fifth Circuit speaks as follows:

> The right of the United States to present a claim in a bankruptcy case at any time while the bankruptcy is pending and the funds thereof are not distributed can not be disputed.

Under the circumstances of the present case the above language seems entirely appropriate, and I am of the opinion that the United States is altogether within its rights in the presentation of

its claims despite the fact that more than one year had elapsed since the bankruptcy adjudication, especially as the funds in the trustee's hands to a considerable extent remain undistributed, and property in the course of administration under the Bankruptcy Act is not freed from liens or claims for taxes. 29 L. R. A. 280, 283; *In re Epstein,* 156 Fed. 42, 84 C. C. C. 208, 17 L. R. A. (N. S.) 465; *Stokes* v. *State,* 46 Ga. 412, 12 Am. Rep. 588.

(2) The referee certifies that all the assets which came into the trustee's hands were the assets of the partnership, except $1,000, which was realized from the individual estate of Hugo Schaefer.

The testimony shows that each of the partners was entitled to 50 per cent of the net profits of the partnership and a salary of $10,400 per year. The partners, instead of drawing out their respective 50 per cent shares of the net profits from year to year, left a considerable portion in the business undistributed, and during the years 1917, 1918, and 1919 the distributive share of each partner, in excess of the amounts actually withdrawn by him, totaled $26,140.05, or a little more than $52,000 in all, left in the business.

The Government tax, assessed against the two partners individually for the same three years, totaled $13,701.98; each partner being assessed for approximately one-half thereof, and the taxes so assessed not having been paid.

Pursuant to the conclusions already reached hereinabove, there would seem to me to be no doubt as to the government's right to priority of payment, provided only that there be funds in existence

properly chargeable with such payments. And in this connection it must be remembered that the taxes here sought are claimed as having accrued on the various dates when, under the income tax laws then in force, they originally became due and payable. There is no dispute but that, on these various days, there were actual funds in being, voluntarily left by Brezin and Schaefer among the partnership moneys, and which, if they had been claimed by the partners as individuals—as with perfect propriety they could have claimed under the articles of copartnership—would have more than sufficed to put the individuals in possession of resources out of which these taxes could have been paid and satisfied. Has the refusal or neglect of the partners to claim their individual rights from time to time, their election to leave their respective personal moneys in their business enterprise so changed the character of those moneys, so undermined the government's claim as practically to nullify it, and, at the same time, put in possession of the trustee, for the benefit of partnership creditors, many thousands of dollars which, as the result of the partners' mere election, are listed as partnership funds, whereas, they were actually, at all times throughout the period herein involved, individual funds, even though unclaimed? I believe not, and although, as claimed by counsel for the trustee, there is, under the terms of section 3186, Revised Statutes (Comp. St. § 5908), no specific statutory lien in this case, I am yet of the opinion that sections 3466, Revised Statutes, and 64a of the Bankruptcy Act do give the government a priority right in the premises, and that such priority right as thus set forth is a declaration of the common-law right of

the sovereign to be first paid. *U. S.* v. *National Surety Co.*, 254 U. S. 73, 41 Sup. Ct. 29, 65 L. Ed. 143.

> At common law the crown of Great Britain, by virtue of a prerogative right, had priority, over all subjects for the payment out of a debtor's property of all debts due it. The priority was effective alike whether the property remained in the hands of the debtor, or had been placed in the possession of a third person, or was in custodia legis. The priority could be defeated or postponed only through the passing of title to the debtor's property, absolutely or by way of lien, before the sovereign sought to enforce his right. * * * The right of priority has been likened to an equitable lien. *State* v. *Rowse*, 49 Mo. 586; *Marshall* v. *New York*, 254 U. S. 382–386, 41 Sup. Ct. 144, 145 (65 L. Ed. 315).

At all times, during the years in question, as already said, there were funds in the business to which each partner, under the articles of copartnership, might have laid claim as his own. They were his to do with as he pleased, and they were the very funds which, in part, served as the foundation for the imposition of the tax, collection of which is herein sought. The fact that each partner was willing to forego the physical withdrawal of these funds can not, in my opinion, succeed in defeating the government's equitable lien.

It should be borne in mind that this proceeding is not designed to tax the partnership for taxes due from the individuals, and therefore runs in no wise counter to the Revenue Acts of 1917. (Com. St. § 6336–3/8a et seq.) and of 1918 (Com. St. Ann. Supp. 1919, § 6336–1/8a et seq.) The

taxes herein have been assessed against the individuals, and all that is now sought is an available and proper fund out of which to collect the same, as so assessed.

(3) The government's claim for taxes is not to be classed with a creditor's claim for the payment of an ordinary debt, for "taxes are not debts, but imposts levied for the support of the government." *U. S.* v. *Proctor* (D. C.), 286 Fed. 272; *New Jersey* v. *Anderson*, 203 U. S. 483, 27 Sup. Ct. 137, 51 L. Ed. 284. See, also *Lane County* v. *Oregon*, 7 Wall 71, 19 L. Ed. 101; *Meriwether* v. *Garrett*, 102 U. S. 472, 26 L. Ed. 197; *Crabtree* v. *Madden*, 54 Fed. 431, 4 C. C. A. 408; *City of Camden* v. *Allen*, 26 N. J. Law, 398.

Therefore, in my opinion, the government's claim, being in the nature of an equitable lien, has followed the property into the hands of the trustee in bankruptcy, where it awaits satisfaction. And this satisfaction, so far as Hugo Schaefer is concerned, should first be had by applying to the government's claim the $1,000 found by the referee to be his individual property.

Concerning the referee's finding that no assets of any kind belonging to the said individual partners came into possession of the trustee in bankruptcy, and that neither of the individual partners had any taxable income for the years involved which could form the basis of a tax claim against them, it is worthy of note that the bankrupts themselves do not agree with that conclusion, as evidenced by the sworn schedules of assets and liabilities filed by them in the bankruptcy proceeding.

An examination of these schedules shows that they charge themselves as owing the United States

$3,887.19 and $3,921.21, respectively, for income taxes; the same being approximately the totals of the amounts claimed to be due from them on original returns filed for the years 1918 and 1919. These statements are, of course, not binding on the trustee, but, in view of the fact that they are so clearly declarations against interest, taxes not being dischargeable claims, they would seem to be strongly confirmatory of the Government's contention that the funds to which, under the articles of copartnership, the individual partners were entitled to lay claim and yet left in the partnership, were, in truth, individual moneys, so far as a governmental tax collection matter is concerned. To argue otherwise were to establish the right of the individual connected with a partnership, to determine largely what should or should not be subjected to taxation.

The 1921 Revenue Act (Comp. St. Ann. Supp. 1923, § 6336⅛a et seq.), as did the 1918 act, provides that individuals carrying on a partnership business shall be liable for income tax in their individual capacity only, and that there shall be included in computing the next income of each partner his distributive share, whether distributed or not, of the next income of the partnership for the taxable year, or if his income is computed upon the basis of a period different from the basis upon which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any annual accounting period of the partnership ending within the fiscal year or calendar year, upon the basis of which the partner's net income is computed.

In the instant case there were admittedly net profits accuring to each partner during the years 1917, 1918, and 1919, and while it may be true that in 1920 there occurred a loss of more than $40,000, which in effect wiped out the prior profits, I am yet of the opinion that, inasmuch as the undisturbed net profits of each individual partner for 1917, 1918, and 1919 were more than sufficient to pay the government's tax and were in nowise so earmarked as to indentify them with the funds paid out in connection with the loss in 1920, the funds remaining in the trustee's hand are liable in their entirety for the government's lien until the same is paid; in other words, that each individual partner, during those years, had in reality a taxable income forming the basis for a tax claim against him.

(4) The loss in 1920 can not in any event be charged against the profit of the three previous years, for the reason that the Revenue Act of 1918, § 204, in force when this loss occurred, provides that the only net loss which a taxpayer might deduct was a loss in the operation of his business occurring after October 31, 1918, and before January 1, 1920. This loss, having occurred subsequent to this last-named period, is only deductive on a return of income for 1920.

Inasmuch as the undistributed profits in a partnership are to be sued, as far as they extend as the basis for the computation of an individual income tax, a partner possessed of such profits certainly has a taxable income, and such income, even in the guise of partnership funds, is available for collection, as well as computation, purposes.

I am, therefore, of the opinion that the Government is right in its contention (1) that the so-called

partnership assets of Brezin and Schaefer, made up as they were, are liable for the payment of taxes owed by the individual partners, and (2) that both of the individual partners had taxable incomes for the years 1917, 1918, and 1919, properly forming the basis of a tax claim against them.

The order of the referee, therefore, so far as it disallows the Government's demand and instructs the trustee that the same does not constitute a claim against the estate in his hands, is reversed.

An order in conformity with the views herein expressed may be presented and will be signed.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924—No. 515.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue,

Petitioners-Appellants,

—against—

HENRY H. KAUFMAN, Trustee in Bankruptcy of Abraham Finkelstein, Israel Finkelstein and Nettie Finkelstein, individually and as co-partners trading as Finkelstein Brothers,

Appellee.

BRIEF FOR THE APPELLEE IN OPPOSITION TO MOTION FOR WRIT OF CERTIORARI.

WALTER M. CHANDLER,
Of Counsel for Henry H. Kaufman,
Trustee in Bankruptcy of Finkelstein Bros.

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BRIEF FOR THE APPELLEE IN OPPOSITION TO MOTION FOR WRIT OF CERTIORARI.

Statement.

The firm of Finkelstein Brothers, a copartnership, is bankrupt. The copartners, Abraham Finkelstein, Israel Finkelstein and Nettie Finkelstein, have also been individually adjudged bankrupt.

The balance of income tax for the year 1919 amounting to $11,523.30, with interest from January 22, 1922, is owing by Abraham Finkelstein, individually.

Henry H. Kaufman of 115 Broadway, New York, N. Y., is Trustee in Bankruptcy for both Abraham Finkelstein individually and the firm of Finkelstein Brothers.

The testimony taken before the Referee indicated that no assets of Abraham Finkelstein, individually, came into the Trustee's hands, and that the assets he holds was derived solely from property of the copartnership. The question before the Court is whether the Government may receive payment of its claim out of the copartnership funds in the hands of H. H. Kaufman, Trustee in Bankruptcy of Finkelstein Brothers.

The testimony introduced relative to the claim of the Government was adduced before Hon. John J. Townsend, Referee in Bankruptcy, on April 26, 1923, at 4 P. M. Henry H. Kaufman, Esq., the Trustee in Bankruptcy of this proceeding, who was also Receiver in this proceeding prior to his appointment as Trustee, testified that the only assets which came into his possession as Receiver or Trustee were assets and property to which title was vested in the partnership estate and that he received no assets belonging to the individual estate of Abraham Finkelstein against whom the Government asserts its claim for taxes.

The single question presented may be stated as follows: *Is the United States of America entitled to be paid, out of partnership assets in the possession of a Trustee in Bankruptcy, for a tax assessed against an individual who is a member of a partnership, ahead of general creditors of the copartnership?*

Argument.

It is contended by the appellee in this case that the question presented, as it is above stated, should be answered in the negative.

To be specific, the United States claims to be entitled to payment of its tax assessed against Abraham Finkelstein who is a member of the copartnership of Finkelstein Brothers from the partnership assets ahead of the partnership creditors. The claim of the Government for taxes is solely and peculiarly an individual debt of Abraham Finkelstein.

POINTS.

I.

The claim of the Government for Income Tax accruing for the year 1919 and assessed by the Government against Abraham Finkelstein, is an individual debt of Abraham Finkelstein and is not a debt of the partnership.

Under the Revenue Act of 1917 (Title 2, Sect. 201), a tax was imposed and assessed directly upon copartnerships.

> "Sect. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in

> this title referred to as the tax) equal to the following percentages of the net income: * * *"

By virtue of this section the Government assessed a tax against every *corporation, partnership or individual.* Congress repealed the Act of 1917 and substituted in its place the Revenue Act of 1918 (Act of February 24, 1919, 40 Stat. 1057).

Section 218 (a) which is hereinafter set forth at length, provides that individuals carrying on business as partnership, "shall be liable for tax only in their individual capacity."

> "SECT. 218 (a). *That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.* (Italics ours.) There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed."

Previous to the repeal of the Revenue Act of 1917, Congress provided that a tax shall be levied, assessed and collected from every corporation, partnership or individual. The Revenue Act of 1918, which was substituted in the place of the Revenue Act of 1917, Section 201 specif-

ically provides that individuals carrying on business in partnership shall be liable for income tax "only in their individual capacity." The section, in addition to providing for the assessment of the tax against individuals and not against partnerships, defines the manner in which the tax shall be computed.

Section 224, which is set forth at length (on p. 28, Transcript of Record), provides that a partnership shall file a return setting forth specifically which is gross income, the net income, the names and addresses of individuals entitled to participate in the net income of the partnership. The purpose of this section is to enable the Government to verify the returns filed of individuals who are members of partnerships. Congress by the repeal of the Revenue Act of 1917 (Title 2, Section 201), completely changed the method of deriving revenue. It was clearly the intention of Congress to make individuals of partnerships liable personally and in their individual capacity. Congress repealed *in toto* the Revenue Act of 1917 which provided for the assessment of a tax on partnerships and substituted in its place the Revenue Act of 1918 which provides for the assessment of a tax against individuals. Congress provided for the collection of the taxes by the Revised Statutes of the United States (Sections 3186, 3187, Stat. 1016), which provides that a lien is created upon all property and rights to property belonging to such persons.

Sections 3466 and 3477 of the Revised Statutes provide that the Government shall have a prior lien or preference upon all assets of an insolvent or deceased debtor, and that a representative of an insolvent and deceased person should become answerable in his own

person, should he fail to pay the tax of the United States prior to other debts.

It is evident that the intention of Congress by the enactment of Sections 3466, 3467, herein cited, and hereinafter set forth at length, was to protect and give to the United States a lien upon assets belonging to an insolvent or deceased debtor. There is nothing, however, in the statute that would indicate that the intention of Congress was, by the enactment of Section 218 (a) of the Revenue Act of 1918, which repealed in entirety Section 201 of the Revenue Act of 1917, to make a partnership liable for the debt of an individual member of the copartnership. *The lien is created against property belonging to the individual.*

Congress repealed the Act of 1917 which provided for a tax assessed against a partnership. It is evident that no other conclusion can be drawn but that the intention of Congress was to make the individual member of a partnership, and not the partnership, liable for taxes. If it were not, the intention of Congress to make individuals liable in their own individual capacity for taxes accruing from profits made in a partnership, there would have been no purpose for Congress to nullify the Revenue Act of 1917 and substitute in its place Section 218 (a) of the Revenue Act of 1918, which effects a complete revision of the Revenue Act of 1917.

Sections 3466 and 3467 read as follows:

> "SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due

to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

"SEC. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto upon all property and rights to property belonging to such person: Provided, however, that such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated: Provided further, Whenever any State by appropriate legislation authorizes the filing of such notice in the office of the registrar or recorder of

> deeds of the counties of that State, or in the State of Louisiana in the parishes thereof, then such lien shall not be valid in that State as against any mortgagee, purchaser, or judgment creditor, until such notice shall be filed in the office of the registrar or recorder of deeds of the county or counties, or parish or parishes in the State of Louisiana, within which the property subject to the lien is situated."

Section 3186 of the Revised Statutes of the United States (37 Stat. 1016) is concise and it is evident from the language of the statute that a lien created for taxes takes effect only upon property belonging to the delinquent at the time the demand for the payment of the tax is made, and then attaches to the delinquent's property.

In the case of *United States* v. *Pacific Railroad*, 1 Fed. 97, the United States filed a bill in equity to enforce a lien upon property formerly owned by the Pacific Railroad for taxes. When the tax accrued, the Pacific Railroad was the owner of the property against which the lien was sought to be enforced, but since that time, several large mortgages were executed upon the property, and under a foreclosure of one of these, the property was sold to an individual who subsequently conveyed the property to the Missouri Pacific Railway Company who was the owner at the time the suit was commenced.

The Government alleged in its bill, that demands were made for the payment of the taxes, which demands were made subsequent to the execution of the mortgages and the purchase of the property by the present owner. The defendants demurred to the bill on the ground that even

if the Government had a lien, it only took effect at the time the demand is alleged to have been made and since it was made subsequent to the sale and conveyance of the property the Government's claim is subject thereto.

The Court in construing the words of the statute "upon all property and rights of property belonging to such person, bank, association, company or corporation" (same language is contained in present section), held that the section applied to the property belonging to the Pacific Railroad Company when demand was made, by which the lien was created.

Mr. Justice Miller in the case of *U. S.* v. *Pacific Railroad Co.*, 4 Dillon 71, said:

> "In construing this section, it is proper to consider the extraordinary nature of this lien; it is not only a lien upon the land but is a lien upon personal property; it is not only a lien upon property in possession but upon all rights to property depending upon contracts, and upon unexecuted contracts; it not only relates a present lien but it relates back."

Justice McCrary (*U. S.* v. *Pacific R. R.*, 1 Fed. 97), on p. 99, in construing the opinion of Mr. Justice Miller, said:

> "I think I am within the spirit of that opinion when I say that the statute should not be construed as subjecting property which has been conveyed to innocent persons prior to any demand. Unless this is its plain meaning, the consequences of such a ruling would be so serious and far-reaching that I should not be willing to invoke them by any doubtful interpretation."

The section which was construed by the Court in this case is practically identical with Section 3186 of the Revised Statutes, *supra*. Congress if it intended that partnerships should be made liable for debts of its individual members and that a lien should attach against partnership assets, would have expressed itself in unequivocal terms.

The primary question involved in this claim is whether Congress intended by the repeal of the Revenue Act of 1917 to create a tax against the individual members of a partnership or whether it intended to create a tax against the partnership as an entity. That is the only question involved. The language of Section 218 (a), *supra*, clearly indicates that the intention of Congress was to create a tax against individual members of a copartnership and not against the copartnership itself. The language of the new section is clear, and the intention of Congress is apparent.

In the case of *Union Central Life Insurance Co.* v. *Champlain Co., et al.*, 116 Fed. 858, on p. 860, Sanborn, Circuit Judge, said:

> "The courts may not import into a plain and unambiguous law and give effect to a supposed intention or purpose of the legislative body which is neither expressed nor indicated in the act. Such a course of action would pass beyond the limits of construction or interpretation into the forbidden domain of judicial legislation."

The Revenue Act of 1918 is plain and unambiguous in its terms. It is apparent from the first sentence of the section that Congress clearly intended that an in-

dividual member of the firm shall become liable in his individual capacity. The first sentence of Section 218 (a) of the Revenue Act of 1918 is as follows:

> "That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

There is no other deduction that can be drawn from the first sentence of Section 218 (a) of the Revenue Act of 1918 but that Congress clearly intended to create a liability against the individuals only. If the contention of the Government is correct that Congress intended by the Revenue Act of 1918 to make both the individual members of the firm and the partnership liable there would have been no purpose for Congress to repeal the Revenue Act of 1917, and substitute in its place the new section which in unequivocal terms creates a tax against the individuals only.

The elementary and primary rule of law in order to ascertain the legislative intent is that a statute is to receive the meaning which the ordinary reading of its language warrants. The language of the statute is clear and demands but one meaning. The statute would be intended to mean what it has clearly and plainly expressed, and there is no room for construction.

In *Re Southern Railway Company* v. *Machinists Local Union, No. 14, et al.,* 111 Fed. 49, the learned Judge, in his opinion in substance, said "that it is not for the Courts to inquire as to the motive of the legislature nor to limit the meaning clearly conveyed in unambiguous words."

Nothing in this issue is better illustrative of the

intention of Congress than a comparison of the Revenue Act of 1917 which Congress repealed and the Revenue Act of 1918 which was enacted in its place. One conclusion can only be drawn as to the intention of Congress. The change is apparent. It is a complete reversal on the part of Congress as to the manner in which revenue shall be derived.

II.

A claim for taxes assessed against an individual, who is a member of a copartnership, is payable from his individual assets and from his separate estate; not from assets which belong to a copartnership of which he is a member.

The rule of law is well settled that the effects of a copartnership cannot be applied by one partner to the payment of his private debts, and title of the copartnership assets is not vested in a separate creditor of one of the partners, nor is title to any of the property of the copartnership vested separately in the individual members of the copartnership. Title to the partnership assets is vested jointly in all the members of the copartnership. The Bankruptcy Act of 1898, Section 5 F, provides that the net proceeds of the partnership property shall be appropriated to the payment of the partnership debts.

The fact that there are no partnership assets available for distribution to partnership creditors or vice versa, is not sufficient to create grounds for deviating from the rule of distribution as laid down in Section 5 F

of the Bankruptcy Act of 1898. This section is so definite as to provide a uniform rule of distribution against which there can be no exception introduced by judicial construction.

In *Re Farmers & Mechanics National Bank of Philadelphia* v. *Ridge Avenue Bank*, 240 U. S. 498, Mr. Chief Justice White delivering the opinion of the Court, in substance decided, under Subdivision F of Section 5 of the Bankruptcy Act of 1898, when a partnership is insolvent and when each individual member is also insolvent, and when the only fund for distribution is produced by the individual estate of one member, the individual creditors of that member are entitled to priority in the distribution of the fund.

The principle of law involved in this issue is well settled, and the Courts have held that even where an appropriation to the individual debt of one partner is made of any part of the firm property even with the assent of the copartner the appropriation is illegal and void if the firm is not left with sufficient money to pay its copartnership debts.

Menagh v. *Whitwell*, 52 N. Y. 146.

The principle cited is an equitable principle and was embodied by Congress as a statutory requirement and as a provisional remedy under the Bankruptcy Act by the embodiment of the principle in Section 5 F of the Bankruptcy Act. This rule of law is well settled and has been recognized as an equitable principle of law by the Chancellors of England. The Courts have even held that where the claims of creditors of a copartnership have been reduced to judgment either before or after the

filing of the petition in bankruptcy of the firm and the partners, the fact that the judgment has been rendered does not in any way change the character of the claim and the assets must be distributed in accordance with Section 5 F of the Bankruptcy Act.

In re F. J. Hacker & Co., et al., 225 Fed. 869.

The claim of the Government in this case is a liability against Abraham Finkelstein in his individual capacity. This is peculiarly an individual liability of Abraham Finkelstein only. There is no liability imposed upon the other members of the firm. A liability is only imposed upon each of the members of the partnership for debts created by the partnership as an entity. It requires no citations to state that an individual may contract debts in his individual capacity even though he may be a member of a copartnership.

The only difference in the issue involved here and where an individual who is a member of a copartnership contracts or incurs a debt in his individual capacity is that in one he agrees to become liable by his own assent and in the other a compulsory contribution for the support of the Government is assessed. In both cases, it is needless to say, he is liable. One arises as a result of contract, and the other is imposed by law. It is, therefore, evident that if an individual who may be a member of a partnership acts in his individual capacity and creates obligations in his individual capacity, that the copartnership assets cannot be used to satisfy the claims created by or against the individual. The only remedy that creditors of the individual have would be to sequestrate his interest in the partnership after all the firm's liabilities have been paid.

The copartnership of Finkelstein Brothers is not responsible for an individual debt or tax of Abraham Finkelstein, the individual member. Congress has provided for the method of collecting its tax and has provided for the method in which the tax shall be assessed, all of which has been dealt with at length in Point I of this brief. Congress has in no wise deviated from the rule of marshalling assets as laid down in Section 5 F of the Bankruptcy Act, and the Government accordingly is bound by that rule.

In *Re James, et al.*, cited by the Circuit Judge of this Court, 133 Fed. 912, Lacombe, Circuit Judge, speaking on behalf of the Court, said:

> "It was within the discretion of Congress to leave this subject of the mashalling of assets to the Courts, to be disposed of in accordance with equity principles and practice, or to provide that the general rule should be modified in particular cases. It has done neither. On the contrary, it has itself directed how the assets shall be marshalled, and it has done so in language broadly covering this case as well as all the others. The language is plain, explicit and unambiguous; it names no exception; its phraseology conveys no intimation that any exception is contemplated. To inject into the act an excepting clause where none has been enacted would seem to be judicial legislation."

Congress has in no manner created any provision excepting the United States Government from this rule of law. It must be presumed, therefore, that Congress

had intended that the sovereign shall be bound by the provisions of Section 5 (f) of the Bankruptcy Act.

Section 3466, *supra*, was invoked in the case of *Guaranty Co.* v. *Title Guaranty Co.*, 224 U. S. 152, and the Supreme Court held that it was superseded by the Bankruptcy Act. The learned Court said at page 160:

> "The act takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state, and individual and shows the order of payment."

In *Re Hull*, 224 Fed. 796, Killits, *D. J.*, said (p. 799):

> "Indeed, it is difficult to see wherein the language of Paragraph F of Section 5 permits the grafting of an exception. The first sentence so definitely provides how various classes of debts shall be paid as to seem to leave no room for any variation. It reads:
>
> > 'The net proceeds of the partnership shall be appropriated for the payment of partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts.'
>
> This language, read literally, excludes opportunity for the partnership debts to participate in the fund derived from the individual estate of a partner, except as provided in the subsequent sentence of the paragraph; that is, only when the individual estate yields a surplus above the individual liabilities. In the absence of an authoritative holding in this circuit, it seems to us that the better course is to follow the second and fourth

circuits, already cited, and to hold that the statute is so definite as to provide a uniform rule of distribution against which there can be no exception introduced by judicial construction."

The appellant has cited *In re Strausberg*, 4 Woods 557, 23 Fed. case No. 13526. This citation has no bearing upon the principle involved in this claim.

In the case cited by the Government the obligation was created by reason of a bond executed by the individual members of the partnership in their individual capacity. In this case it is noteworthy to observe the language of the learned Judge in his opinion at page 558:

> "*When the United States has a claim against one member of a firm and not against the other its priority only extends to the interest of that member.*" (Italics ours.)

In *Re Lewis* v. *U. S.*, 92 U. S. 618, cited by the Government, obviously for two reasons. One is to uphold the contention of the Government that the United States of America as a sovereign power is in no wise bound by the Bankruptcy Act, and the other to show that the United States can assert its interest against the partnership assets for the satisfaction of the debt of an individual member.

In *Re U. S.* v. *Wood*, 290 Fed. 109, the Court decided the question of jurisdiction of the Court over the United States in bankruptcy matters. It distinguished the case in *Re Lewis* v. *U. S., supra*, and held that the United States, like any private litigant, is bound by the pro-

visions of the Bankruptcy Act and is not entitled to maintain a suit in equity against the trustee in bankruptcy to enforce its alleged priority to be first paid out of the assets in the hands of the trustee, but must proceed in the Bankruptcy Court.

This Court in its opinion rendered by Rogers, Circuit Judge, on page 113, said:

> "The present Bankruptcy Act was passed in 1898. 30 Stat. c. 541, p. 544. And in *Guarantee Company* v. *Title Guaranty Company*, 224 U. S. 152, 32 Sup. Ct. 457, 56 L. Ed. 706, the court calling attention to certain differences in the provisions of that act as compared with the Act of 1867 in respect to the priorities to which the United States is entitled under the Act of 1898, held that the United States was bound by the Act of 1898 by the provisions of section 64 of that act (Comp. St. Sec. 9648), and that labor claims have priority over debts due to the United States, except in the case of taxes legally due and owing by the bankrupt. The court in that case reversed the Circuit Court of Appeals in the Third Circuit which held (174 Fed. 385, 98 C. C. A. 603) that the United States was not bound by the Bankruptcy Act, and that under the Act of 1797 (now Revised Statutes, § 3466) the government was entitled to a prior payment irrespective of the Bankruptcy Act."

Relative to the contention of the Government under the *Lewis* case, *supra*, as to the distribution and the marshalling of assets, a reading of the case will show that the subject matter involved has no bearing upon

the issue at bar. In the case cited, the only question involved was the right of the Government to preferred payment out of the estates of the individual partners wherein the individuals were indebted to the United States and had separate estates, while the present case involves the opposite, namely, the right of the Government to preferred payment out of the partnership estate of a claim against an individual member of the partnership.

The proposition that the United States may *prove*, as a preferred creditor against an individual estate, a debt owing by a partnership of which the individual is a member is not disputed, because an individual is responsible for the debts of the partnership. The liability of an individual who is a member of a partnership is both joint and several. As an individual he owes the debt as much as the partnership, and the law clearly provides that if a debt is owing by any individual to the Government, the Government is a preferred creditor with reference to such debt and to such individual. But a partnership is not responsible for the debts of an individual partner. It, therefore, follows that the principle of the *Lewis* case is wholly inapplicable.

There can be no controversy as to the rule of law governing the relations between an insolvent firm and its creditors and their mutual rights in respect of the firm's property. The partnership as such has its own property and its own creditors, distinct from the individual property of its members and their individual creditors. The firm creditors are preferentially entitled to be paid out of firm assets, whatever may be the foundation of the equity, it is now an undisputed element in the security of the firm creditors. The in-

solvent firm cannot apply the firm assets in payment of the individual debts of the partners, nor can the equity of the firm creditors be defeated by an attempted conversion of the assets of the firm into the individual assets of one of the partners through a transfer of one partner therein to the other.

Bulger v. *Rosa*, 119 N. Y. 459.

In *Re Flatau & Stern*, 21 A. B. R. 353, a motion was made by the City of New York for an order directing the trustee in bankruptcy to pay to the City of New York the sum of $162.50 on account of taxes assessed against Nathan H. Flatau, one of the bankrupts individually. In this case the City asserted the right to be paid and its tax satisfied from the assets in the possession of the trustee which belonged to the partnership. Willis, Referee, writing the opinion in this case, on page 355, said:

> "In my judgment there can be no reasonable doubt that outside the Bankruptcy Act, a 'personal tax' is in every respect a 'debt' within the legal meaning of the word, and I can see nothing in the provisions of the Act itself to alter the situation in such regard. The act provides, however, in express terms that unpaid taxes shall be included among 'debts not affected by discharge,' and also that they shall be paid 'in advance of the payments of dividends to creditors' * * *."

In *Re McClure & Barton*, New Series, 3 A. B. R. 119, the Learned Referee followed the ruling in *Re Flatau & Stern*, *supra*, in substance decided that taxes on the property of an individual bankrupt partner will not be

paid out of partnership assets until the partnership creditors are paid in full.

Congress in enacting the Bankruptcy Act specifically mentioned the United States, and in Section 17 of the Bankruptcy Act of 1898 it provides that a discharge in bankruptcy shall release a bankrupt from all of his provable debts except such as are due as a tax levied by the United States, the State, County, District or Municipality in which he resides. Nor is the section previously cited the only one wherein the United States is specifically mentioned. The United States is mentioned in Section 64 of the Bankruptcy Act of 1898 which deals with "debts which have priority." There is but one logical and only conclusion to be drawn that Congress intended that the United States in bankruptcy matters shall submit itself to the Court which is vested with bankruptcy powers. Congress has accorded the United States every possible advantage of properly asserting its interest against one who is insolvent.

In *Re Anderson,* 279 Fed. 526, held that United States is subject to the provisions of the Bankruptcy Act. Manton, Circuit Judge, writing the opinion on behalf of the Court at page 29 stated:

> "The United States must file its claim for taxes as any other creditor, if it desires to share in the estate, and the Court must determine any question arising as to the amount or legality of such tax. It cannot stand by, as it did here after permission having been granted to file its claim, and expect to subsequently collect the tax from the bankrupt or its trustee. To permit such a procedure would make it impossible to say when

there could be a winding up of the bankruptcy proceedings and the distribution of the assets. The trustee may only pay out the assets under an order of the Referee or the Court and without such order he could not pay the income tax due the Government. If the Government had a priority it could easily be determined in this proceeding and it clearly was the intention of Congress that it should be determined under the command of Section 64, where the United States is specifically mentioned. We think that it was the intention to have settled promptly in the bankruptcy proceedings all matters of taxes due the United States. The Bankruptcy Act evidently does not contemplate that taxes should be proved, like an ordinary debt, providing, as it does, that they shall be paid by the trustee by order of the Court and that he shall have credit in his accounts upon filing receipts from the proper officials therefor."

Section 64 (a) declares:

"The Court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, County, District, or Municipality in advance of the payment of dividends to creditors and upon filing the receipts of the proper public officials for such payments he shall be credited with the amount thereof and in case any question arises as to the amount or legality as to any such tax the same shall be heard and determined by the Court."

It was determined in the *Anderson* case that the Court had the unquestioned right to determine the

amount or legality of the claim or any question that arose as a result of proving the tax claimed.

No one can doubt but that the provisions of the Bankruptcy Act are ample for the protection of the Government in proving its claim and Congress clearly intended as appears in Section 64 (a) of the Bankruptcy Act of 1898 that this Court was to exercise the exclusive and sole privilege of determining any question which may arise in connection with a claim for tax due the United States from an insolvent person, partnership or corporation. Nothing in the Bankruptcy statute provides that assets of an insolvent person, partnership or corporation shall be marshalled or distributed in any other manner than is provided for by Section 5 F.

The Government's contention is saturated with imputations of the equitable lien of the United States for taxes and the collection thereof from any source. It is needless to devote any space to the principle of law that the Government cannot seize property in payment of a debt for taxes where the person owing the tax has no legal interest, share or right to property which is held by a copartnership of which he is a member.

In order to fully counteract the imputation throughout the brief filed on behalf of the Government, it is necessary to resort to the academic principles of partnership law. It is axiomatic and requires no citation of law that a creditor of an individual who is a member of a partnership cannot assert or satisfy his claim from the assets of a partnership beyond the interest which the individual member may have in the partnership. In simple and concise terms it would simply mean that the debts of the partnership creditors would have to be

satisfied before the interest of any individual member of the partnership could be determined.

The Government's contention merely reduces itself to an absurdity and is tantamount to saying that the Government is entitled to assert a lien against the individual's assets or against any assets, whether his or not, that may be found in a partnership of which he is a member.

The Court is not concerned whether the trustee in bankruptcy or Finkelstein Brothers has assets which belong to Abraham Finkelstein individually. The order of the Referee dated August 24, 1923, provides that the claim of Frank K. Bowers as Collector of Internal Revenue of the Second Collection District of New York be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein (Rec., p. 18).

The question before this Court is whether the Government has a claim against Finkelstein Brothers as a copartnership or against Abraham Finkelstein who is a member of that corporation.

Partnerships and corporations are in effect the same to this end; both constitute an aggregation of divergent and plural interests, and to that end it may be said that in effect each is a separate entity and is formed for the sole purpose of holding interests under one supreme power.

The revised statute specifically provides that a corporation shall file a return for all its taxable income and that a corporation shall be held responsible for the tax. Congress, if it saw fit could have exempted corporations from taxation and provided that individual stockholders of the corporation were to be held responsible for their undistributed share in the corpora-

tion. In the case of partnerships it is not as in the case of corporations, Congress has by concise terms created a lien for taxes against individual members of partnership but not against the partnership as an entity, and the act specifically provides that individuals shall file returns setting forth their income and that they shall be taxed thereon, and partnerships are only directed to notify the Government by return as to the taxable income of the individuals. A tax upon the return of the partnership is not computed or assessed against the partnership. It is fair to assume that the provision for the filing of a return by the partnership is merely a precaution taken by Congress to insure the proper collection of taxes by the Government from the individuals.

The interest of an individual member in a partnership attaches, only, after the payment of the partnership debts.

In *Re L. Stein & Co.*, 127 Fed. 547, Jenkins, Cir. Judge, said:

> "The present bankruptcy act recognizes the equitable rule that partnership property is primarily a fund for the payment of copartnership debts, and that the interest of a copartner is subject to that special equity, and attaches only to the surplus remaining after the payment of the partnership debts. It treats the copartnership as a legal entity, irrespective of the status or the separate rights of the individual copartners. It deals with the copartnership as a person for the purpose of subjecting the partnership property to the satisfaction of the copartnership liabilities."

In the case of *Schnall* v. *Camers*, 251 U. S. 239, the

Supreme Court of the United States emphasized the distinction between individual debts and partnership debts saying:

> "Hence the distinction between individual and firm debts is a matter of substance, and must depend upon the essential character of the transactions out of which they arise. And since, in this case, the tort was done in the course of the partnership business, for the benefit of the firm and without benefit to the partners as individuals no legal or equitable claim as against the individuals that might be deemed to arise out of it by waiver of the tort or otherwise, can displace the equities of other creditors, recognized in the Bankruptcy Act, and put petitioners in a position of equality with others who actually were creditors of the individual partners, and of preference over other firm creditors."

In this case, the controlling provisions of law specifically and unquestionably make the Government's claim one against the individuals and only against the individuals. The partners are "liable for tax only in their individual capacity." Partnerships are not subject to any tax whatsoever. The Government cannot therefore be put in a position of priority or even equality with others who actually were creditors of the partnership, because "the net proceeds of the partnership property shall be appropriated to the payment of partnership debts" (Section 5 (f) Bankruptcy Act), and this is not a partnership debt.

The appellant in its brief refers to the fact that the distributive share of the partnership income for 1919 left by Abraham Finkelstein in the partnership was

$59,440.99. The appellant in its brief submitted to the Circuit Court of Appeals for the Second Circuit referred to a balance sheet attached to the partnership return showing the net worth of Abraham Finkelstein. There is no proof, and the record does not contain any reference to the balance sheet attached to the return or any intimation, as to what the distributive share of Abraham Finkelstein was for 1919. It is therefore assumed that for the purpose of this issue it is unnecessary to discuss the point. Assuming, however, that there was a distributive share accruing to Abraham Finkelstein of $55,440.99 for 1919 it would not necessarily indicate that at the time the appellant's lien for taxes accrued that there was due Abraham Finkelstein the distributive share which he left with the partnership.

None of the profits due Abraham Finkelstein from the partnership of Finkelstein Brothers was set aside or put into a separate fund, solely for the use of Abraham Finkelstein. It is immaterial whether the profits which accrued to Abraham Finkelstein were withdrawn from the firm assets or not, for the purpose of this discussion. There is nothing in the record to show that a division was made or any separate account created to preserve the individual interest of Abraham Finkelstein. Abraham Finkelstein's interest in the partnership was undivided and merged with the interest of the other partners.

The Government in its brief prominently cites the case of *Brazen & Schaefer*, 279 Fed. 300, decided by Judge Runyon in the U. S. D. C. for the District of New Jersey. A reading of the learned Judge's opinion in this case will clearly indicate that the primary and moving

cause for his decision was the definition as to the meaning of a tax. The learned Judge stated in his opinion:

> "The Government's claim for taxes is not to be classed with a creditor's for payment of an ordinary debt, for 'taxes are not debts but imposts levied for the support of the Government.'" (Appendix, p. 38 of Government's brief.)

Section 8 of the Constitution of the United States would clearly indicate that the framers of the Constitution of the United States intended that the word tax was to mean something other than an impost. Section 8 of the Constitution of the United States reads:

> "The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States."

The framers of the Constitution did not intend to classify taxes with duties, imposts or excises, and specifically exempted "taxes" from that provision of Section 8 of the Constitution, which provides that "all duties, imposts and excises shall be uniform throughout the United States."

The District Court for the Southern District of Florida, in *U. S.* v. 59 *Demijohn*, 32 Fed. 401, by Locke, *D. J.*, said:

> "It is true the word 'tax' in its most extended sense may include all contributions imposed by the government of whatsoever kind and descrip-

> tion whether against person or property, but in its more confined sense it is used in contra-distinguishment of duties and imposts. * * * In a careful examination of the numerous instances in which the word 'tax' is used throughout the entire statutes of the United States, I have failed to find one where it can with any degree of satisfaction be applied to duties and imposts. The early legislation of the country upon revenue appears to show it to have adopted the restricted use of the term and they used it in no other sense. * * * The term 'tax' was only intended to apply to the internal revenue and the term 'duty' and 'import duty' to customs."

In *Re James Pedlow & Co.*, 32 A. B. R. 808, it was held that a judgment obtained by the United States for a loss of revenue arising out of undervaluation, by the bankrupt, of imports is not a tax within the meaning of Section 64 (a) of the Bankruptcy Act entitling the Government to priority. The trustee in the *Pedlow* case claimed that "debts" due to the United States are not entitled to priority under the Bankruptcy Act but only taxes are so entitled and that "duties" are not "taxes." The United States, however, claimed that it is wholly immaterial what name may be given to a tax under Section 64 (a); it is none the less a "tax" because it is given another name. The main question presented to the Court in the case was whether the judgment obtained by the United States is for a tax duty, impost or excise, mentioned in the Constitution, Section 8 of Article 1. There is a clear distinction between "tax" and "duties" provided in the Constitution. "Duties" must be uniform throughout the United States. There is no restriction as to "taxes."

"Taxes" are used in the Constitution in their "natural and obvious sense," and are not to be enlarged or narrowed from their "natural and obvious import."

In support of that, *Block v. Farmer's Loan & Trust Co.*, 158 U. S. 601.

Revenue laws should be strictly construed in favor of the citizen against the Government.

U. S. v. Wigglesworth, 2 Story, 369.

"Taxes" and "duties" are separate and distinct under the statutes of the United States. The Bankruptcy Act of 1867 gave priority to all debts due to the United States and all taxes and assessments under the laws thereof (Act of 1867, Sec. 28). The present Act gives priority only to "all taxes legally due and owing by the bankrupt to the United States" (Sec. 64).

The change of the phraseology of the Act of 1867 and the Act of 1898 giving priority to the United States is significant.

The Bankruptcy Act is uniform and exclusive throughout the United States and the Bankruptcy Court supreme as to all matters within its jurisdiction. The obvious conclusion to be drawn from the numerous decisions by the Court is that "taxes" are different and import a meaning different than "imposts or excises." If, as the learned Judge holds in the *Brazen & Schaefer* case, that a tax is an impost, the Government would not be entitled to priority of payment and would only be entitled to share as a general creditor under the present Bankruptcy Act. The Bankruptcy Act of 1898

gives priority only to "all taxes legally due and owing by the bankrupt to the United States."

In re Pedlow, supra.

The Government's claim must either be classed as an impost or a tax, for a definite and special meaning is conveyed by each word. If the claim is an impost it is a general claim against the individual estate and if the claim is classed as a tax the Government is bound by the Bankruptcy Act which gives it a preference, since the Bankruptcy is "uniform and exclusive throughout the United States, and the Bankruptcy Court supreme as to all matters within its jurisdiction."

The Government cannot have the law construed in any manner different than it would be construed for any other creditor. The law is well settled that the debt of an individual member of a partnership is not provable against the partnership but is only provable against his individual estate.

The learned Court in the case of *Brazen & Schaefer* reached an erroneous conclusion, because of its misapplication of the well defined legal principles.

The Government's brief in support of its contention cites Section 5G of the Bankruptcy Act which in fact provides that "The Court may marshal the assets of the partnership estate and individual estates so as to secure the equitable distribution of property of the several estates." The conclusion reached by the Government in its brief regarding this section of the Bankruptcy Act is not supported by any citation or authority. The proposition was pertinently raised in the case of *Telfer*,

184 Fed. 224, and in construing Section 5G of the Bankruptcy Act, said that "this clause is construed with reference to the clause F."

The *Telfer* decision which interprets Section 5G of the Bankruptcy Act which provides:

> "That the Court may permit the proof of the claim of the partnership estate against the individual estates and vice versa, and may marshal the assets of the partnership estate and the individual estates so as to prevent preferences and to secure the equitable distribution of the property of the several estates."

Held that it does not change the established equity rule of distribution between partnership and individual creditors, which is expressly recognized in Subdivision "F"; and, while the trustee of a partnership estate may prove a claim against the individual estate of a partner such claim is not entitled to payment pro rata with those of individual creditors, but only from the surplus, if any, remaining after the individual claims have been paid.

The claim of the Government wherein it seeks to be paid, in the case at bar, from the partnership assets for an individual debt is unfounded and is not supported by any equitable or legal principle.

In *Re Bertenshaw*, 157 Fed. 363, Judge Sanborn, in the course of his opinion stated:

> "There are two conceptions of a partnership, one springing from the agreement on which it is founded, that it is an aggregation of persons as-

sociated together to share its profits and losses, owning its property, and liable for its debts. The other that it is an artificial being, a distinct entity separate in estate, in rights, and in obligations from the partners who compose it. In most of its relations to persons and things the latter conception is the more accurate."

In *Re Mills* v. *J. H. Fisher & Co.,* 159 Fed. 897, the Court in passing upon the effect of the Act of a member of a partnership in transferring the whole of his estate to satisfy the claim of a partnership creditor, Mr. Justice Lurton said:

> "A partnership under the Bankruptcy Act of 1898 is a distinct entity—a person—* * * As an entity it may be adjudged to be a bankrupt irrespective of any adjudication against the individual members."

The Government alludes to the fact that Abraham Finkelstein permitted his share of the profits of Finkelstein Brothers to remain undistributed and left all his money in the partnership estate. For the purpose of determining this issue it is immaterial whether the money was withdrawn by him from the firm or not. It is settled law; assuming Abraham Finkelstein left his share of the profits undistributed in the partnership he could not recover it until all of the partnership liabilities have been paid. The test is did the partnership hold for him in trust any money or property set aside separately and distinct from the partnership assets. In this case it did not.

In *Re Effinger,* 184 Fed. 728, the learned Court held

that the claim of a partner for money loaned to the partnership in excess of the amount he was bound to contribute as his share of the capital is unquestionably provable against the partnership estate; but it cannot share in the distribution of that estate until all of the firm creditors are paid.

In the present issue there is no contention that Abraham Finkelstein contributed more than he was bound to contribute to the partnership nor that the partnership owed him any money at the time the petition in Bankruptcy was filed. No proof has been introduced to sustain that proposition and assuming if that were the fact it would still remain wholly immaterial as far as the right of a creditor of an individual, who is a member of a partnership, to share in the partnership assets is concerned.

CONCLUSION.

For the reasons hereinbefore set out, it is urged that the United States of America is not entitled to payment of its claim against Abraham Finkelstein from the partnership assets in the possession of the trustee in bankruptcy, and that the order of the Referee in Bankruptcy, the District Court of the United States for the Southern District of New York, and the Circuit Court of Appeals for the Second Circuit, should be affirmed in all respects.

Respectfully submitted,

WALTER M. CHANDLER,
Of Counsel for Henry H. Kaufman, Trustee in Bankruptcy of Finkelstein Bros.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue, Petitioners, AGAINST ALFRED C. COXE, JR., as Receiver of JONES & BAKER, alleged bankrupts.	No. 516.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Preliminary.

A single petition has been filed in cases No. 515 and 516 for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit. This brief is in opposition to the petition in case No. 516, although substantially the same question of law is involved in both cases, and a single opinion was written in the Circuit Court of Appeals in determining them. (See Opinion printed in appendix.)

ARGUMENT.

I.

The United States is not entitled to have the partnership assets applied to the payment of taxes due to it from the individual members, prior to the payment of the partnership creditors.

The claim of the United States is for taxes due from W. R. Jones and Jackson B. Sells as individuals only (fols. 38, 44, 50, 56). The two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals. We understand it to be conceded that there is no indebtedness for taxes due the United States from the partnership. Under the 1918 Revenue Act it is admitted taxes could only be assessed against the individuals. Sections 218-A and 224 of the 1918 Revenue Act provide as follows:

"Section 218 subdivision A: That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

Section 224: That every partnership shall make a return for each taxable year stating specifically the items of its gross income and the deductions allowed by this title and shall include in the returns the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

The partnership is required to furnish the necessary information return to enable the government properly to determine the amount of income tax

assessable against the individual partners. The partnership is not made liable for the payment of taxes. This was not true under the prior 1917 Act, which imposed a graduated excess profit tax against the partnership. (Title II, Section 201, Rev. Act of 1917.)

The Bankruptcy Act specifically provides that,—

> "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

It has been repeatedly held that the distinction between individual and firm debts is a matter of substance and cannot be disregarded.

In re Wilcox, 94 Fed. 84;
In re Janes, 133 Fed. 912;
In re Schall vs. *Camors*, 251 U. S. 239.

In the brief submitted in support of the petition it is stated that it was admitted that there were no individual assets. This may be true in the *Finkelstein* case (No. 515) but it is not true in the *Jones & Baker* case. Both the partners, Jones and Sells, had individual estates, now in the hands of the Receiver, although not sufficient to pay the amount of the taxes due by these individuals to the government.

The decision relied upon in the petition and brief, *In the Matter of Brezin & Schaeffer* (297 Fed. 300),

decided by the District Court of New Jersey, is discussed and disposed of in the opinion of the Circuit Court of Appeals (*infra*, p. 18).

The statement in the Government brief that the decision of the court below,—

> "* * * opens the door to evasion of taxes and will seriously delay and hamper the collection of the public revenue (p. 8)"

is not only incorrect but entirely fanciful. If the individual partners are solvent, they must, of course, pay their taxes to the government. If the partnership estate is solvent then the interests of the partners may be reached. There can be no possible evasion. The partners cannot benefit in any way. The question determined by the court below was that where the assets of a partnership estate are being administered in a bankruptcy court, and are insufficient to pay the partnership creditors, then a tax assessed against the individual partners is not payble out of the partnership assets prior to the payment of the partnership creditors.

In passing upon petitions for writs of certiorari where the determination of the Circuit Court of Appeals is otherwise final, this court only concerns itself "with questions of gravity and importance".

> *Ex Parte Lau Ow Bew*, Petitioner, 141 U. S. 583.

It is respectfully submitted that the petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit should be denied.

Dated, September 24, 1924.

JOSEPH M. HARTFIELD,
Of Counsel for Alfred C. Coxe, Jr.,
Receiver of Jones & Baker,
Alleged bankrupts.

APPENDIX.

Opinion of Circuit Court of Appeals.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

IN THE MATTER OF ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN and NETTIE FINKELSTEIN, individually and as copartners trading as Finkelstein Bros., Bankrupts, *Re:* Claim of FRANK K. BOWERS, Collector of Internal Revenue for the Second District of New York, for $11,523.30. UNITED STATES OF AMERICA and FRANK K. BOWERS, as Collector of Internal Revenue for the Second District of New York, Appellant, AGAINST HENRY H. KAUFMAN, Trustee in Bankruptcy, Appellee. IN THE MATTER OF JONES & BAKER, Alleged Bankrupts.	Before: ROGERS, HOUGH & MAYER, *Circuit Judges.*

These two appeals were argued at the same time and will be disposed of in one opinion.

In the *Finkelstein* case the District Court for the Southern District of New York affirmed the order of the Referee in bankruptcy allowing the claim of Bowers, Collector, against the individual assets of Finkelstein, but not against the partnership assets. The facts are sufficiently set forth in the opinion of Referee Townsend which, because of its careful review of the question litigated, we quote *infra.*

In the *Jones & Baker* case, the District Court for the Southern District of New York reached the same conclusion on a different state of facts, in respect of which, however, there is no difference in principle from what was held in the *Finkelstein* case.

The facts in the *Jones & Baker* case may be briefly stated.

Jones & Baker was a partnership composed of two partners, William R. Jones and Jackson B. Sells, and was engaged in the stock brokerage business. On March 31, 1923, an involuntary bankruptcy proceeding was commenced against the firm in the District Court for the Southern District of New York and a receiver was appointed.

An offer of composition in bankruptcy was made by the firm to the partnership customers and creditors, as distinguished from the creditors of the individual partners, which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. No offer of composition was made to the creditors of the individual partners. This offer of composition was confirmed by the District Court, and the Receiver was directed to carry it into effect. Under the composition the

creditors of the firm cannot by any possibility recover the full amount of their claims.

In July, 1923, more than one month after the appointment of the receiver, the government, upon a re-examination of the individual tax returns of the individual partners, for the years 1918, 1919 and 1920, assessed certain additional income taxes against Jones for $632,768.04 and Sells for $62,-661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts.

As the result of negotiations, a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned.

The government, however, has endeavored in the bankruptcy proceeding to assert these claims as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the

use and benefit of the creditors of the firm and has endeavored to enforce the two claims as being entitled to payment out of the firm's assets prior to the customers and creditors of the firm.

The opinion of the Referee in the *Finkelstein* case follows:

> "The Collector's claim * * * asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.
>
> The question of priority and of rate of interest will be reserved by the Referee for the present.
>
> The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourths aggregating $11,523.30 form the basis of the present claim.
>
> On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.
>
> It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 15, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interests in the partnership at that time.
>
> At the hearing it appeared that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property

of Abraham Finkelstein. It was conceded Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is, however, conceded that in this there is no surplus.

At the hearing the government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general co-partnership creditors.

At the hearing the Trustee contended that the government's claim was only payable out of any individual assets (of which in this case there were none) belonging to the individual estate of Abraham Finkelstein within subdv. *f* of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

> 'That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *'

It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly im-

posed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

'Sec. 218 (*a*) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.'

'Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.'

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled 'Part II-individuals.'

In my opinion the sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.: Section 218(*a*) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdv. *f* of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkel-

stein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

I find nothing in the Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the *res* which the Collector may seize. Those three sections read as follows:

'If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *

'Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.'

'Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the

debts so due to the United States, or for so much thereof as may remain due and unpaid.'

Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets, which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finelstein as an individual under Section 218(*a*) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above.

Congress having deliberately chosen the plan of taxation indicated in those sections, instead as assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Collector is precluded from asserting the different rule here contended for by him, even if (as he points out)

the statutory plan works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner 'in his individual capacity'.

I read the following cases as supporting the views expressed in this memorandum:

U. S. v. *Hack,* 8 Peters, 271;
U. S. v. *Evans, Crabbs,* 60; 2 Fed. Cases, #15,062.

The Collector relies on the following cases:

In re Straussberger, 4 Wood, 557, 23 Fed. Cases, #13,526;
Lewis v. *U. S.,* 92 U. S. 618.

In the *Straussberger* cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claim of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning 'When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc.'

I cannot read the *Lewis* case as impairing the prior decision of the U. S. Supreme Court in *U. S.* v. *Hack.* The facts were as follows:

The United States had a claim against the partnership of Jay Cook McCullough & Co. of London, hereafter called the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States.

The Supreme Court merely decided that the United States holding a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector—that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors—which is the proposition condemned in *U. S.* v. *Hack, supra.*

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Revenue against the partnership assets of Finkelstein Brothers in priority to the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy."

ROBERT P. LEVIS (MAX E. SANDERS, of counsel), for Appellee, Henry H. Kaufman, Trustee.

WHITE & CASE (LYLE T. ALVERSON, ALFRED C. COXE, J. M. HARTFIELD, HENRY H. KAUFMAN, WM. ST. JOHN TOZER and RALPH WOLF, of counsel), for Receiver Coxe.

WILLIAM HAYWARD, U. S. Attorney, NELSON T. HARTSON, Solicitor of Internal Revenue, RUSSELL N. SHAW, Special Attorney, Bureau of Internal Revenue, and VICTOR HOUSE, Special Asst. U. S. Attorney, for Appellants.

MAYER, Circuit Judge:

The fundamental fallacy of the contention on behalf of the government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible.

The authority to tax must be found somewhere. The Revenue Act of 1918, in section 1400 thereof, specifically repealed, *inter alia,* Title I including section 8(*e*) of the Revenue Act of 1916 and Title II, including section 201 of the Revenue Act of 1917.

The provisions of the tax statute here concerned are thus section 218(*a*) and section 224 of Title II of the Revenue Act of 1918. As pointed out in the opinion of the Referee, *supra,* there is not the slightest warrant for concluding that the tax was against partnerships and not solely against the "individuals carrying on business in partnership". The language of Section 218(*a*) is too plain for extended discussion, and its meaning could be fortified, if necessary, by the contrast between the Revenue Act of 1917 and the Revenue Act of 1918 in this regard.

As, therefore, there was no income tax against the partnership in either of the cases at bar, we must look to the bankruptcy statute to ascertain whether it affirmatively provided that the tax assessed against the individuals could be proved against the partnership estate. We need not pause to consider what distinction, if any, there is between "debts" and "taxes" in various parts of the Bankruptcy Act. We may also assume for the purpose of the argument that, if the Revenue Act of 1918 authorized assessment of the tax against the partnership instead of against the individuals, it might not have been necessary to name the United States in any provision as to marshalling.

The point, however, is that, as there is no tax against the partnership, the only remaining theory upon which the tax against the individuals can be proved against and recovered out of the partnership estate is that the Bankruptcy Act of 1898 so provided.

Section 5, subdivision (*f*) of that act did not so provide. This provision reads:

> "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

There can be no longer any doubt that the distinction between individual and firm debts is a matter of substance which cannot be disregarded.

In re Wilcox, 94 F. R. 84;
In re Janes, 133 F. R. 912;
In re Schall v. *Camors*, 251 U. S. 239;
In re Jarmulowsky, 287 F. R. 703.

There is, of course, no doubt that the right of priority of the United States in the collection of taxes is an attribute of sovereignty.

Marshall v. *New York*, 254 U. S. 380.

Under section 64(*a*) of the Bankruptcy Act of 1898, it is the duty of the court to order the trustee to pay all taxes, legally due and owing by the bank-

rupt to the United States, in advance of the payment of dividends to creditors; but, of course, the tax must be "legally due and owing by the bankrupt to the United States".

U. S. R. S., sections 3186, 3466 and 3467, deal with tax priority, but there is nothing in the provisions of these sections which changes the tax against an individual into a tax against the partnership. Numerous instances will be found in the case of *In re Wilson*, 252 F. R. 631, which illustrate the difference between the identity of the fund or person against whom a claim can be made and respective priorities once the fund or person is found or determined. If, therefore, the Congress had intended that the tax against the individuals should be paid out of the partnership estate prior to the payment of the partnership debts it would have so declared by some affirmative language to that effect either in sections 5(*f*) of the statute or in some other provision.

It must be remembered that the Bankruptcy Act of 1898 has now been in operation for a little over a quarter of a century and that business has been done on the faith and basis of the statute. It can readily be seen that a partnership might not be able to obtain the same amount of credit from banks and other lending sources if in marshalling the assets of a partnership, such assets become a fund out of which the debts or taxes due and owing from the individual members are payable prior to or *pari passu* with the partnership debts.

As pointed out by Judge Rogers in *United States v. Wood*, 290 F. R. 109, there is a marked difference between the Act of 1898 and previous acts in respect of the relation of the United States to the present bankruptcy act. In the case just cited, there is a review of many cases illustrative of this proposition.

It is hard to believe, in view of the definite language of section 5(*f*) that the legislature intended to create a situation where the debts or taxes due from the individuals might wipe out or share with the debts due from the partnership; for any such provision might well have been most detrimental to business and commerce. Of course, it is always within the power of the Congress to tax the partnership as distinguished from the individuals, but where, as here, no such tax exists, we confess that we are unable to find anywhere in the Bankruptcy Act of 1898 any provision which authorizes the collection of the tax from property which was never taxed.

> *United States* v. *Hack*, 8 Peters, 271;
> *United States* v. *Evans*, 25 Fed. Cases, 1023.

The cases of *Lewis* v. *United States*, 92 U. S. 618, and *In re Strassburger*, 23 Fed. Cas. 224, have been analyzed in the opinion of the Referee and the *Lewis* case has been further commented upon in the *Wood* case, *supra*, at pages 111 *et seq*.

Our attention has been called to a decision of the District Court of New Jersey in the *Matter of Brezin & Schaefer*, not reported. We are unable to agree with this decision. (Note.) There is nothing in the record of either of the cases at bar upon which an equitable lien against the partnership assets may be asserted in favor of the United States. "Equitable lien" is often used synonymously with "equitable assignment" and "impressing a trust". An excellent definition is found in *Lighthouse* v. *Third National Bank*, 162 N. Y., at page 344:

> "One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.

Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge."

See also

Pomeroy on Equity, Fourth Edition, Vol. 3, Section 1233;
Bispham on Equity, 4th Edition, Sec. 351;
Ketchum v. *St. Louis,* 101 U. S. 306;
Walker v. *Brown,* 165 U. S. 654;
National City Bank v. *Hotchkiss,* 231 U. S. 50, 57;
In re National Cash Register Co., 174 F. R. 579;
In re See, 209 F. R. 172.

Every element of an equitable lien is absent in each of the cases here under consideration.

Finally, there is no merit in the suggestion that the marshalling provisions are not applicable in the *Jones & Baker* case because there the composition in that case was had before adjudication. The composition was only with the partnership creditors and there was no composition with the creditors of the individual partners. This was warranted by Section 12 of the Bankruptcy Act, as amended June 25, 1910. *In re Breitbart.* 291 F. R. 693.

A composition whether before or after adjudication, so far as affects the questions here presented, stands in the same position as a liquidation through a trusteeship in bankruptcy. (See opinion of Referee Remington, *Matter of Simon Fox,* 6 A. B. R. 525, 530.)

It is plain that under the Bankruptcy Act, it is intended that its administrative sections shall apply whichever method of administration may be chosen.

We think it unnecessary to comment in detail upon many cases cited in the briefs. It is sufficient to observe that three cases upon which some emphasis is laid by appellant, *i. e., Matter of Menist,* 294 F. R. 532; *U. S.* v. *McHatton et al.,* 266 F. R. 602, and *Titus* v. *Maxwell,* 281 F. R. 433, either are not relevant to the question here under consideration or contain nothing to disturb the conclusion that the decrees below were correct.

Decrees affirmed.

(*Note.*) See interesting article in *Columbia Law Review,* April, 1924, entitled "The Priority of the United States in the Payment of its Claims against a Bankrupt", by Ralph F. Colin, at pages 360, 371 and 372.

No. 515

IN THE

Supreme Court of the United States

October Term, 1934.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue,

Petitioners,

vs.

HENRY H. KAUFMAN, Trustee in Bankruptcy of ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN and NETTIE FINKELSTEIN, individually and as co-partners, trading as FINKELSTEIN BROS.,

Bankrupts.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

WM. SIEBERT, INC., PRINTER, 9-15 MURRAY ST., N. Y.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue, Petitioners, *against* HENRY H. KAUFMAN, Trustee in Bankruptcy of ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN and NETTIE FINKELSTEIN, individually and as co-partners trading as FINKELSTEIN BROS., Bankrupts.	No. 515

Brief in Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

A single petition has been filed in cases 515 and 516 for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

A brief in opposition to the petition in case No. 516 has been submitted, to which there is appended the opinion of the Circuit Court of Appeals for the Second Circuit.

The opinion of the Circuit Court of Appeals

contains a copy of the opinion written by the Referee in Bankruptcy.

The arguments advanced in the brief submitted in case No. 516 are relied upon in this proceeding. The facts in case No. 516 are substantially alike.

This learned Court is respectfully referred to the brief filed in case No. 516 and we rely upon the opinion rendered by the Circuit Court of Appeals for the Second Circuit, and upon the arguments advanced by counsel in case No. 516.

It is respectfully submitted that the petition for writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit should be denied.

Dated, New York, October 2, 1924.

Jonah J. Goldstein,
Counsel for Henry H. Kaufman,
Trustee in Bankruptcy of
Finkelstein Bros.

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue, Petitioners, AGAINST ALFRED C. COXE, JR., as Receiver of JONES & BAKER, Alleged Bankrupts.	No. 516.

BRIEF FOR RESPONDENT, ALFRED C. COXE, JR., AS RECEIVER OF JONES & BAKER.

This case comes before this Court on certiorari allowed to the Circuit Court of Appeals for the Second Circuit, where it was heard and decided at the same time as *In re Finkelstein,* one opinion being written in both cases (Rec. p. 49).

Substantially the same question of law is involved in both cases, viz:

Is a claim for income taxes, assessed against an individual, provable in bankruptcy against the assets of the firm of which he was a member, where the partnership assets are concededly insufficient to pay the firm's debts?

The order of the District Court, affirmed by the Circuit Court of Appeals, provided:

> "Ordered that the claims filed herein by the United States for income taxes due from William R. Jones in the amount of $273,739.07, and from Jackson B. Sells in the amount of $5,-518.41, be disallowed and expunged as claims against the assets of the firm of Jones & Baker" (Rec. p. 48).

Facts.

The partnership of Jones & Baker, composed of two partners, William R. Jones and Jackson B. Sells, was engaged in the stock brokerage business in New York City and other cities until the 31st day of May, 1923. On that date an involuntary bankruptcy proceeding was commenced against the firm in the United States District Court for the Southern District of New York, and Alfred C. Coxe, Jr., was appointhed Receiver for the firm (Rec. p. 36).

An offer of composition in bankruptcy was then made by the firm to the partnership customers and creditors, *as distinguished from the creditors of the individual partners,* which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, the date of the receivership, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. *No offer of composition was made to the creditors of the individual partners.* The individual partners however had separate estates insufficient to pay their separate creditors including the claims filed for taxes. This offer of composition was confirmed by the District Court, and the Re-

ceiver directed to carry it into effect. Under the composition the creditors of the firm of Jones & Baker cannot by any possibility recover the full amount of their claims (Rec. pp. 38-39).

In July, 1923, more than one month after the appointment of the Receiver, the Government, upon a re-examination of the individual tax returns of Jones and Sells, the individual partners, for the years 1918, 1919 and 1920, assessed certain *additional* income taxes against Jones for $632,768.04 and Sells for $62,661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims are entitled in the bankruptcy proceeding, and are specifically stated to be against the individuals.

The Jones Claim reads (Rec. p. 41):

"Comes Frank K. Bowers, Collector of Internal Revenue for the 2nd Collection District of New York, a duly authorized agent for the United States in this behalf, and says that W. R. Jones, Bankrupt, is justly and truly indebted to the United States of America for internal revenue taxes," describing the claim as for income tax for the year 1920, amount $632,768.04, and stating "that no part of the tax has been paid, but that the tax is now due and payable."

The Sells claim (Rec. p. 43) is in identically the same language, excepting that it states "that Jackson B. Sells, Bankrupt, is justly and truly indebted to the United States of America for internal revenue taxes, as follows:" describing the claim as for income tax for the year 1920, amount $62,661.89.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts, namely, against Jones for $534,149.42, as net additional income taxes for the years 1918, 1919 and 1920, and against Sells for $54,872.02, as net additional income taxes for the same period (Rec. pp. 42-43).

There then followed negotiations with the Commission of Internal Revenue, and as a result a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and William R. Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Jackson B. Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned (Rec. pp. 39-40).

Although it was evident upon the face of the claims and from all the facts surrounding them that these claims were merely against the individuals composing the partnership, the Government has endeavored in the bankruptcy proceeding to assert them as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the use and benefit of the creditors of the firm. Furthermore, the Government has endeavored to enforce the two claims as being entitled to payment out of the firm's assets, prior to the creditors of the firm.

On motion of the Receiver, and after full hearing, the District Court directed that the two claims of the United States be expunged and disallowed against the assets of the firm of Jones & Baker (Rec. p. 45).

The Circuit Court of Appeals unanimously affirmed the order (Rec. p. 58).

In the *Finkelstein* case the tax was assessed against the taxpayer prior to the bankruptcy, but as creditors of the partner could have no right to partnership property until all partnership liabilities were paid, we do not believe it important whether the tax was assessed prior to, or after the bankruptcy proceeding was commenced. However, we call the Court's attention to the fact that in the *Jones & Baker* case the tax was not even assessed until after the bankruptcy petition had been filed.

In the government's brief (p. 3) it is stated that there were no separate individual estates. There is nothing in the record in this case that supports any such statement, and as a matter of fact, both Jones and Sells as individuals had separate estates which have come into the hands of the Receiver. Neither estate is, however, sufficient to pay the claims filed against the individuals by the government for taxes. No offer of composition was made by the individuals and the composition which was confirmed related solely to partnership creditors.

It was stipulated in the court below (Rec. p. 45) that if the court was of the opinion that it was material in determining the claims asserted by the government, to ascertain whether or not the individuals had obtained their income from the partnership estate, further proof could be offered by the parties.

POINT I.

The claims in question are for taxes assessed against William R. Jones and Jackson B. Sells, as individuals only, and are therefore debts of the individuals, and not debts of the partnership estate.

We understand this is conceded.

An examination of the proofs of claim filed by the Government with the Receiver shows clearly that the Government regarded the claims as individual debts of the individual partners, Jones and Sells, for taxes upon their individual incomes. The claim against Jones states "that W. R. Jones, bankrupt, is justly and truly indebted to the United States of America for Internal Revenue taxes", naming the amount. The Sells claim states in identically the same language "that Jackson B. Sells, bankrupt, is justly and truly indebted to the United States of America for Internal Revenue taxes", and states the amount (Rec. p. 41).

Furthermore, the stipulations already referred to reducing the taxes previously claimed were entered into separately by the Commissioner of Internal Revenue with each partner and signed by each partner as the taxpayer. No mention whatsoever is made in either stipulation of the other partner, or of the tax claimed to be due from him (Rec. pp. 39-40).

Moreover, under the 1918 Revenue Act, these taxes could only be assessed against the individuals.

Sections 218-*a* and 224 of the 1918 Revenue Act provide as follows:

> "Sec. 218 (*a*) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."
>
> "Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

The partnership is not made liable for the payment of taxes. It is merely required to furnish the necessary information return to enable the Government properly to determine the amount of income tax assessable against the individual partners. This was not true under the prior 1917 Act, which imposed a graduated excess profits tax upon the partnership. (Title II, Sec. 201, Rev. Act of 1917.)

POINT II.

The question here is not one of prior right, but as to the estate against which the claims in question can be asserted.

The argument presented on behalf of the Government in their brief misses this point entirely and argues a proposition which is not disputed, viz: that a claim for taxes is entitled to priority of payment out of the assets of the taxpayer against whom

it is assessed. We do not here question that right. But that is not the right which was asserted and passed on by the Courts below. The right asserted was to have a tax claim against the individual partner, paid out of firm assets, before firm creditors were paid in full. The Circuit Court of Appeals well said, as to this (Rec. p. 55):

> "The fundamental fallacy of the contention on behalf of the Government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible."

How unsound the argument for the Government is can be seen by considering the statement at page 11 of their brief, which reads as follows:

> "Certainly Congress did not intend that a partner by his own acts should place rights to property or income beyond the reach of taxing authorities and therefore deprive the Government of tax in violation of the plain intent of all the law."

Can it be possible that they mean that if an individual spends, loans or gives away all his income and does not retain enough to pay the tax which the Government will later assess against him, that the Government can pursue that income into the possession of the merchants to whom the individual paid it, or have any more right to recover it from persons who have received it in good faith than the individual would have. That would be the logical conclusion of such an argument.

Certainly there were no surplus profits in this estate when the Receiver took possession, because the assets are concededly insufficient to pay the partnership creditors.

Upon the bankruptcy of a partnership, the law is well established that there must be a marshalling

of assets and liabilities, and firm liabilities are to be paid out of firm assets and individual liabilities out of individual assets.

The provisions of the 1898 Bankruptcy Act relating to the marshalling of assets in partnership cases, are found in Section 5, subdivision *f*, as follows:

> "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

This section of the Bankruptcy Act has frequently been before the Federal Courts for construction, and it has been repeatedly held that the distinction between individual and firm debts is a matter of substance and cannot be disregarded.

In re Wilcox, 94 Fed. 84;
In re Janes, 133 Fed. 912;
In re Schall vs. *Camors,* 251 U. S. 239.

In *Schall* vs. *Camors* (*supra*) Mr. Justice Pitney, at pages 254 and 255 of the opinion, used the following language:

> "Section 5 of the Bankruptcy Act (30 Stat. 547-548), establishes on a firm basis the respective equities of the individual and firm creditors. Hence the distinction between indi-

vidual and firm debts is a matter of substance, and must depend upon the essential character of the transactions out of which they arise."

In re Janes (*supra*) Judge Lacombe writing for the Circuit Court of Appeals, in the Second Circuit, said as follows:

> "We are of the opinion that the rule to be applied is the rule laid down in the sections above quoted from the bankrupt act. It was within the discretion of Congress to leave this subject of the marshalling of assets to the courts, to be disposed of in accordance with equity principles and practice, or to provide that the general rule should be modified in particular cases. It has done neither. On the contrary, it has itself directed how the assets shall be marshalled, and it has done so in language broadly covering this case as well as all the others. The language is plain, explicit, and unambiguous; it names no 'exception;' its phraseology conveys no intimation that any 'exception' is contemplated. To inject into the act an excepting clause where none has been enacted would seem to be judicial legislation. For this reason, we have reached the conclusion above expressed" (p. 913).

In re Wilcox (*supra*) Judge Lowell traced the history and development of the marshaling rule through the many conflicting decisions, and elaborately discussed the various reasons given by the Courts in its support. His conclusion was that the Bankruptcy Act had dealt with the subject in a clear and comprehensive way and that the language of the marshaling section admitted of no exceptions. Whatever may have been the theoretical justification for the rule, the fact remains that in the present case the firm creditors have a clear right to insist that the firm and individual assets be mar-

shaled between the firm and individual creditors. Otherwise, the individual tax debt of Jones (*which is nearly fifty times that of Sells*) will be used to deplete the firm assets available for distribution to the firm creditors with no corresponding benefit to the firm creditors remaining unpaid.

The provisions of the Bankruptcy Act and the Revised Statutes, giving priority to tax claims, merely make the Government a preferred creditor in the collection of taxes from an estate against which the Government has a lawful claim; these provisions do not create or attempt to create any liability upon an estate against which the Government has no lawful claim.

The Government's contention here is the result of confusing the question of priority with that of identity of the fund or person against whom the claim can be made at all.

Section 64-*a* of the Bankruptcy Act of 1898 provides as follows:

> "The Court shall order the Trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, County, District, or Municipality, in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment, he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax, the same shall be heard and determined by the Court."

The provisions of the Revised Statutes relating to priority are as follows:

> "Section 3186.—Lien for Taxes. If any person liable to pay any tax neglect or refuses to pay the same after demand, the amount shall be a lien in favor of the United States

from the time when the assessment list was received by the Collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may occur in addition thereto, upon all property and rights to property belonging to such person; * * *."

"Section 3466.—Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

"Section 3467. Every executor, administrator or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid."

There is nothing in the above provisions to change the individual tax debts of Jones and Sells into partnership debts. By Section 64-*a* of the Bankruptcy Act, quoted above, the Trustee is directed "to pay all taxes legally due and owing by the bankrupt." The "Trustee" referred to must necessarily be the trustee of the estate of the person who owes the debt to the United States. Not the trustee of another estate. The only taxes legally due and owing in the present case are by Jones and

Sells as individuals, and not by the partnership. The provisions of the priority sections of the Revised Statutes are similar to Section 64-*a* of the Bankruptcy Act. Section 3186 provides that "if any person liable to pay any tax, neglects or refuses to pay" there is to be "a lien upon all property and rights of property belonging to such person." Similarly, it is provided in Section 3466 that "whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied." Here, the persons "liable to pay" and the persons "indebted to the United States" are the individual partners of the firm of Jones & Baker. The partnership is not liable to pay these taxes, and it is in no way "indebted to the United States".

The Government's right of priority in the collection of taxes is an attribute of sovereignty (*Marshall* vs. *New York*, 254 U. S. 380). But this right of priority does not create a new liability where no such liability existed prior to bankruptcy. It merely binds the property of the *tax debtor* under what "has been likened to an equitable lien" (Mr. Justice Brandeis in *Marshall* vs. *New York* (*supra*), at page 386), and permits collection of the Government's prior claim in advance of the claims of other creditors against the same estate.

The individual tax debts of Jones and Sells cannot be paid from the partnership estate until all of the firm creditors have been paid in full.

It is elementary that a partner's individual creditors have no direct interest in partnership property. They can neither attach nor levy execution against the assets of the firm (*N. Y. Partnership Law*, Section 51). Their remedy is to sequester the debtor partner's interest in the firm by appropriate

equitable proceedings (*Ib.*, Section 54). The Government is in no different position with respect to the collection of these individual tax claims from the partnership assets than any other creditor of the individual partners.

Prior to the institution of the bankruptcy proceedings against Jones & Baker, the Government could not have proceeded against the partnership property by distraint or by other summary action prescribed by the Revenue Act. It had no interest in the partnership until the firm debts were fully paid. And when the bankruptcy proceedings were commenced, the provisions of the Bankruptcy Act regarding the marshalling of assets between firm and individual creditors automatically attached. These provisions were binding upon the Government.

That the Bankruptcy Act does bind the United States, and that its rights as well as the rights of other creditors are to be determined by the provisions of that Act, is settled by the construction placed on the Act by this Court.

> *Guarantee Company* v. *Title Guaranty Company*, 224 U. S. 152;
> *Sloan Shipyard* v. *United States Foreign Corporation*, 258 U. S. 549, 574;
> *U. S.* v. *Childs*, 69 Law Ed. 124.

In *Guarantee Co.* v. *Title Co., supra*, this Court, at page 160, referring to the present Bankruptcy Act, said:

> "The Act takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state and individual, and assigns the order of payment."

In *United States of America, Petitioner* v. *Edward H. Childs, Trustee in Bankruptcy of J. Men-*

ist Co., decided by this court November 24, 1924 (Advance Opinion 69 Law Ed., 124) this court said:

> "* * * And notwithstanding the taxes are treated as debts within the meaning of the Bankruptcy Act. *In re Sherwoods,* 210 Fed., pages 754, 158; *Kaw* v. *Boiler Works* v. *Schull,* 230 Fed. 587.

This construction has been put upon the decisions of this Court by the Circuit Courts of Appeals in several circuits.

In the Fourth Circuit, in the case of *Davis* v. *Pringle,* 1 Fed. R. (2d) 860, the Court said:

> "We find no binding authority opposed to the conclusion that the United States has no priority in bankruptcy except for taxes. On the contrary we venture to think it is supported by the reasoning and conclusion of the Court in *Guaranty Company* v. *Title Guarantee Company,* 224 U. S. 152."

In the Eighth Circuit, in the case of *In re Minot,* 298 Fed. 853, the Court said:

> "The fundamental error which pervades the argument of counsel is the assumption that the Bankruptcy Act of 1898 (Comp. St. Sections 9585-9656) does not operate upon and bind the Government of the United States; that the Bankruptcy Acts of 1800 (2 Stat. 19), 1841 (5 Stat. 440) and 1867 (14 Stat. 517) did not have that effect may be conceded; but the Bankruptcy Act of 1898 evinces a change of policy in that respect on the part of Congress and is binding upon the Government of the United States," * * *
>
> "That case [*Guarantee Co.* v. *Guaranty Trust Co.*], however, on that precise point, on appeal was reversed by the Supreme Court of

> the United States, and the rule was laid down, and is now well settled, that the United States is bound by the provisions of the Bankruptcy Law of 1898. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152, 32 Sup. Ct. 457, 56 L. Ed. 706."

In the Second Circuit, *In re Anderson*, 279 Fed. Rep. 525, the Court at page 529 said:

> "The United States must file its claim for taxes as any other creditor, if it desires to share in the estate and the Court must determine any question arising as to the amount or legality of such tax."

See also *United States* v. *Wood*, 290 Fed. Rep. 109.

The individual tax claims against Jones and Sells were thereby excluded from participation in the firm assets.

United States vs. *Hack*, 8 Peters, 271; 8 Lawyers' Ed. 941;

United States vs. *Evans*, No. 15062 Fed. Cases, Vol. 25;

Matter of Flatau vs. *Stern*, 21 A. B. R. 352.

In *United States* vs. *Hack* (*supra*) decided in 1834, the United States sued the assignees of John and Jacob Stouffer, bankrupt partners, on a judgment recovered against Jacob Stouffer, one of the partners, individually, on Customs House bonds. The property in the hands of the assignees was insufficient to pay the firm creditors in full. It was held that the assets should be marshalled, and that inasmuch as the United States only had a claim against one of the individuals composing the part-

nership, it could not share in the distribution from firm assets.

Mr. Justice Thompson, at page 275 of the opinion, said as follows:

> "If then the debt of the United States is not a lien but only entitled to priority of payment out of the general funds of the debtor in the hands of the assignee, what are the funds out of which this priority is set up in the present case? They are not the funds of John Stouffer, the debtor of the United States, but of John and Jacob Stouffer, who have become insolvent and having no separate property; and the partnership property is insufficient to satisfy the partnership creditors. It is a rule too well settled to be now called in question, that the interest of each partner in the partnership property, is his share in the surplus, after the partnership debts are paid; and that surplus only, is liable for the separate debts of such partner."

In *United States* vs. *Evans* (*supra*) decided by District Judge Hopkinson in 1836, one Jonah Thompson was indebted to the United States as surety on certain bonds. He was also in partnership with George Thompson. The partnership assigned, and the firm assets were insufficient to pay the firm debts. It was held that the United States was not entitled to be paid in preference to the creditors of the partnership.

In *Matter of Flatau* vs. *Stern* (*supra*) the City of New York attempted to collect from firm assets, being administered in the Bankruptcy Court, a personal tax claim against one of the partners, individually. This claim was in identically the same position with respect to firm assets as the claims against Jones and Sells in the present case. Ref-

eree Willis, in a well considered opinion, held that the marshalling provisions of the Bankruptcy Act were applicable, and excluded the claim from participation in the firm assets. This decision of Referee Willis was confirmed by the District Court.

The cases cited by the Government in support of its contention are the following:

Lewis vs. *United States*, 92 U. S. 618;
In re Strassburger, No. 13526 Fed. Cases, Vol. 23.

In *Lewis* vs. *United States* (*supra*) the United States had a claim against the partnership of Jay Cook, McCullough & Co. of London (referred to as the English firm). This English firm was composed of seven American partners and three English partners. Jay Cook & Co. of Philadelphia (referred to as the American firm), was composed of the seven American partners of the English firm. On November 26, 1873, the American firm became bankrupt, and Lewis was appointed Trustee in Bankruptcy. The United States asserted against the trustee a claim *against the separate estates of the seven American partners in the* American firm, they being partners in the English firm, which was primarily the debtor to the United States. The Supreme Court decided that the United States, holding a claim primarily against the English partnership, was not bound to go into a foreign jurisdiction to assert its claim against that partnership before proceeding against the separate estates of the partners in this country, but could assert a claim *against the separate estates of the partners* in the possession of Lewis, the trustee in bankruptcy of the American firm. This decision is not authority for the converse proposition

contended for by the Government in this case that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors.

It specifically states the contrary to be the rule. Mr. Justice Swayne, writing for the Court, said at page 624:

> "The bankrupt parties in question were indebted to the United States and they had separate estates. This entitled the United States to the preference claimed. * * *
>
> "The separate and individual interest of the several partners in the partnership property of Jay Cook & Co. can be only the share of each one of what may be left after discharging all the liabilities of the copartnership. This will be nothing, the firm being in bankruptcy and conceded to be hopelessly insolvent. The United States can therefore have no interest with respect to the administration of its affairs."

Each partner is always liable for partnership debts, but the firm is never liable for debts of the partners.

In re Strassburger (*supra*) decided by Mr. Justice Bradley, sitting as Circuit Justice, in 1877, the bankrupts were A. & H. Strassburger, the two members of a copartnership. Between the time of filing the involuntary petition and the adjudication, the United States obtained a judgment against the two bankrupts and one Warren, on a Distillers Bond given by Herman Strassburger, as principal, and Albert Strassburger and Warren as sureties, for Internal Revenue taxes due. The Government claimed priority against the firm assets and its contention was upheld.

On page 224 of the Opinion, Mr. Justice Bradley says:

> "When the United States have a claim against one member of a firm, and not against the other, its priority extends only to the interests of that member, which, as between him and his copartners, is only his share of the partnership assets after all partnership debts are paid. The other partners have a lien on the partnership funds for this purpose; and equity gives the partnership creditors the benefit of this lien when it can do so without violating any principal of law."

This decision was under the Bankruptcy Act of 1867 and was based principally on the holding of the *Lewis* case, 92 U. S. 618, that the United States is not bound by the Bankruptcy Act. This, however, is not the law with respect to the 1898 Bankruptcy Act. Furthermore, in the *Strassburger* case, both partners were liable to the United States for *all of the debt* on the Distillers Bond, which was in effect a joint obligation. There is no such liability in the present case, as each partner is liable only for the tax assessed against him individually. He is in no way liable for the payment of his partners' individual tax. The case is, therefore, within the exception mentioned by Mr. Justice Bradley in the language quoted above. Moreover, the marshalling provisions of the 1898 Bankruptcy Act are more comprehensive and broader than the provisions of the 1867 Act.

POINT III.

There is nothing in the record in this case upon which an equitable lien against partnership assets, may be predicated in favor of the Government.

The question of priority must not be confused with identity of fund against which a claim or lien can be asserted. There is no dispute that a claim of the United States is entitled to priority in the estate against which it is a claim. But that cannot give it any rights in an estate against which it has no claim.

The rights of the United States in such regard (*i. e.*, equitable lien) are governed by the same principles as would apply to any other litigant. There is not one rule for a private suitor and another for the Government.

The contention of the Government appears to be that Jones & Baker, in 1920, realized a profit which resulted in income taxable to the individual partners; that the fund representing the taxable portion of this income, in some way, continued in existence down to and through the Receivership; and that this fund should now be impressed with a lien in favor of the Government for the payment of the additional taxes against the individual partners. The difficulty with this contention is that it runs contrary to well established principles of equity jurisprudence and also that it finds no support in the facts in this case.

An equitable lien is a lien impressed upon specific property, or upon a particular fund capable of ready identification. It has been confined almost entirely to cases where, by agreement of the parties,

a lien was given or was intended and where, for some reason of a technical nature, this lien proved incapable of enforcement, without the interposition of a Court of Equity.

The phrase is used interchangeably with "equitable assignment" and "impressing a trust", and is in a large measure founded on the doctrine of estoppel. In *Lighthouse* vs. *Third National Bank*, 162 N. Y. 336, Judge Werner of the New York Court of Appeals says on page 344 of the opinion:

> "One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.
>
> "Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge." (*Jones on Liens*, sec. 34, and *Grinnell* v. *Suydam*, 3 Sandford, 132.)

In *Pomeroy on Equity*, Fourth Edition, Vol. 3, Sec. 1233, p. 2958, the author defines an equitable lien as follows:

> "It is simply a right of a special nature over the thing, which constitutes a charge or incumbrance upon the thing, so that the very thing itself may be proceeded against in an equitable action, and either sold or sequestered under a judicial decree and its proceeds in the one case, or its rents and profits in the other, applied upon the demand of the creditor in whose favor the lien exists. It is the very essence of this condition that, while the lien continues, the possession of the thing remains with the debtor or the person who holds the proprietary interest subject to the incumbrance. The equitable lien differs essentially from the common-law

lien, which is simply a right to retain possession of the chattel until some debt or demand due to the person thus retaining is satisfied, and possession is such an inseparable element that, if it be voluntarily surrendered by the creditor, the lien is at once extinguished."

To the same effect are

Walker vs. *Brown,* 165 U. S. 654;
Ketchum vs. *St. Louis,* 101 U. S. 306;
Bispham on Equity, 4th Edition, Sec. 351;
In re National Cash Register Co., 174 Fed. 579;
In re See, 209 Fed. 172.

In the present case, there is nothing upon which the Government can predicate a claim of an equitable lien against partnership property. The record is even barren of anything to show that the 1920 income, which forms the basis of these additional taxes, was derived from partnership operations. It might well have been that such income came wholly from sources foreign to the partnership. There is nothing in the present record to show the contrary, and the wide difference in the amounts assessed against the two partners is at least suggestive that the income came from individual, and not partnership operations. The Court cannot, however, indulge in speculation on such a subject. The Government has asserted that a lien exists, and the burden is on it to establish the essential elements of its claim.

But, even if it be assumed that these additional taxes were due to partnership income, there is still no basis for an equitable lien. The partnership was under no obligation to the Government to set aside and hold intact an amount

obligation to pay at the source –

sufficient to liquidate the tax liabilities of the individual partners. Its duty was fully discharged when it furnished the Government with the information necessary to the proper assessment of the taxes against the partners. Otherwise, the plain provisions of the Revenue Act, imposing the tax on the individuals and not on the partnership, would be meaningless.

Furthermore, the practice of the Government in assessing additional taxes years after they are legally due and payable, would make any attempt to create such a fund practically impossible of realization. But, however that may be, the law imposed no such obligation on the partnership and no such fund was in fact created. The Government has not even attempted to identify it, but contents itself with the broad assertion that it has an equitable lien. Clearly, whatever surplus profits there were in the partnership at the end of 1920, have either been withdrawn by the partners or have been lost. If they were withdrawn by the partners for the purpose of paying taxes to the Government, was there an obligation resting on the partnership to see that the withdrawals were properly applied for the purposes intended? And if they were not so applied, are the present creditors of Jones and Baker to be held to have assumed the obligation? These creditors were in no way concerned with the tax liabilities of Jones and Sells to the Government. The property taken over by the Receiver on May 31, 1923, was, in law, their property.

The additional taxes, for which these Government claims have been filed, had not even been assessed at the time of the Receiver's appointment on May 31, 1923. The Government allowed over two years to elapse before the additional assessments

were made, and, during this interval, many innocent creditors had, in good faith, done business with the firm without notice of the Government's claims. Surely, in the light of these facts, there can be no equity in the Government's contention.

On this whole question, the language of Mr. Justice Holmes in *National City Bank* vs. *Hotchkiss*, 231 U. S. 50, at page 57, is most apposite:

> "A trust cannot be established in an aliquot share of a man's whole property, as distinguished from a particular fund, by showing that trust moneys have gone into it. On similar principles, a lien cannot be asserted upon a fund in a borrower's hands, which, at an earlier stage, might have been subject to it, if, by consent of the claimant, it has become a part of the borrower's general estate."

The case relied upon largely by the government, and the opinion in which, is printed as an appendix to their brief (Matter of Brezin & Schaefer), was decided by the United States District Court for the District of New Jersey, prior to the decision of the Circuit Court of Appeals in the instant case. The opinion in the Circuit Court of Appeals (Rec. p. 57) discusses the case and cites fully the authorities which led that court to believe that the decision was incorrect.

The unsoundness of Judge Runyon's decision in the Brezin & Schaefer case is also readily seen by a reading of the following quotation from his opinion:

> "At all times, during the years in question, as already said, there were funds in the business to which each partner, under the articles of copartnership, might have laid claim as his own. They were his to do with as he pleased, and they were the very funds which, in part,

> served as the foundation for the imposition of the tax, collection of which is herein sought. The fact that each partner was willing to forego the physical withdrawal of these funds can not, in my opinion, succeed in defeating the government's equitable lien."

This entirely ignores the fact, evidenced by the firm being in bankruptcy, that the partners have done with these funds as they pleased and that they have withdrawn and spent them either in the conduct of firm business, or for personal uses.

Judge Runyon further says:

> "Therefore, in my opinion, the government's claim, being in the nature of an equitable lien, has followed the property into the hands of the trustee in bankruptcy, where it awaits satisfaction."

But, here again he is giving weight to form, and not substance. If, when the receiver took possession, he had found a package of money or a special deposit labeled or indicated as income of the particular year for which the tax was assessed, then there might have been something to follow, but here there is no attempt whatever to identify what is sought to be followed and, of course, no such identification could be made.

The case of *Titus* v. *Maxwell*, referred to at length by the government (brief, p. 18) is not in point here, as a statement of the facts of that case will show. In that case it was the individual partner (the mortgagee) who was in bankruptcy. The other partner, Johnson, was conceded not to be insolvent, and the mortgage was held by an assignor who had taken for value. The firm had not been adjudicated bankrupt. So that it was the indi-

vidual estate that was being administered. The Court said (281 Fed., p. 438):

> "Here the partnership has not been adjudged bankrupt, nor has Johnson [the other partner] been so adjudged. The Bankruptcy Act does not change the rule that the partnership may be in bankruptcy and the partners not. * * * It is equally manifest that a partner may be in bankruptcy and the partnership not, and that a partnership is not insolvent so long as any of its members has property enough to accomplish satisfaction of the debts of that member together with the partnership debts."

The quotation from that case in the government's brief is misleading because it leaves out an important portion of the paragraph quoted. The paragraph down to the point where the government's quotation ends reads as follows, the portions omitted by the government being in italics:

> "It was long since declared to be the rule in equity that the right of partnership creditors to appropriate the partnership property specifically to the payment of their debts is derived, not through specific lien, but by a sort of subrogation through the partner whose original right it was to have the partnership assets applied to the payment of partnership obligations; that this equity of the partnership creditors subsists so long, and so long only, as that of the partner through whom the equity is derived remains; *that is to say, 'so long as he retains an interest in the firm assets, as a partner, a court of equity will allow the creditors of the firm to avail themselves of his equity, and enforce, through it, the application of those assets primarily to payment of the debts due them, whenever the property comes under its administration'; but that 'if, before the interposition of the court is asked,*

the property has ceased to belong to the partnership, and if by a bona fide transfer it has become the several property either of one partner or of a third person, the equities of the partners are extinguished, and consequently the derivative equities of the creditors are at an end."

POINT IV.

The decree of the District Court, as affirmed by the Circuit Court of Appeals, should be affirmed.

Inasmuch as the government has no claim or lien against the assets of the firm of Jones & Baker on account of additional income taxes assessed against Jones and Sells as individuals, the order appealed from was properly entered and should be affirmed.

Dated, January 5, 1925.

Respectfully submitted,

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WHITE & CASE,
of Counsel.

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UNITED STATES AND BOWERS, COLLECTOR OF INTERNAL REVENUE, *v.* KAUFMAN, TRUSTEE IN BANKRUPTCY OF FINKELSTEIN, ET AL.

UNITED STATES AND BOWERS, COLLECTOR OF INTERNAL REVENUE, *v.* COXE, RECEIVER OF JONES AND BAKER, BANKRUPTS.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Nos. 515 and 516. Argued January 13, 1925.—Decided March 2, 1925.

1. A tax assessed under Revenue Act of 1918 upon the income of a partner, is a tax against the individual and not the partnership,

whether or not his income was derived from partnership business. P. 410.

2. In proceedings in bankruptcy against a partnership the partnership assets must first be applied to the payment of the partnership debts, and the United States is not entitled to any priority of payment out of such assets for a tax due it from an individual partner, except to the extent of the share of such partner, if any, in the surplus remaining after the payment of the partnership debts. Bankruptcy Act, §§ 5f, 64 (a); Rev. Stats. §§ 3466, 3186, as amended, considered. P. 411.

298 Fed. 11, affirmed.

CERTIORARI to judgments of the Circuit Court of Appeals affirming orders of the District Court, in bankruptcy, which denied the right of the United States to have the income taxes of individual partners paid out of the assets of their bankrupt firms in preference to the claims of partnership creditors.

Mr. Merrill E. Otis, Special Assistant to the Attorney General, with whom *Mr. Solicitor General Beck* was on the brief, for the United States.

Mr. J. M. Hartfield, with whom *Mr. Alfred C. Coxe Jr.* and *Mr. William St. John Tozer* were on the brief, for respondents.

MR. JUSTICE SANFORD delivered the opinion of the Court.

These two cases were heard together in the Circuit Court of Appeals. They involve a single question relating to the extent of the priority of the United States in the collection of taxes in bankruptcy proceedings.

In 1921, on an involuntary petition filed in the Southern District of New York, Finkelstein Brothers, a partnership, and the individual partners thereof, were adjudged bankrupts. In 1923 the Collector of Internal

Revenue filed proof of claim for an income tax assessed against Abraham Finkelstein, one of the partners, for the year 1919. It is stipulated that the income on which this tax was based "was derived from the business of the co-partnership." No individual assets of Finkelstein had come into the hands of the trustee, and the partnership assets were insufficient to yield any surplus after the payment of the partnership debts. The Collector claimed that the tax against Finkelstein should be paid out of the partnership assets prior to the partnership debts. The referee denied this claim, and ordered that the partnership assets first be applied to the payment of the partnership debts. This order was affirmed by the District Judge.

In 1923 an involuntary petition in bankruptcy was filed in the same court against Jones & Baker, a partnership. A receiver was appointed, who collected and held the partnership assets. Before an adjudication of bankruptcy the partnership offered a composition to its creditors at less than the full amount of their claims. This was confirmed by the District Judge. Before the partnership assets were distributed, the Collector of Internal Revenue filed proofs of claims against the individual partners for income taxes assessed against them for the years 1918, 1919 and 1920. It does not appear that the income on which these taxes were based was derived from the business of the partnership. The Collector claimed that these taxes should be paid out of the partnership assets prior to the payments to the partnership creditors. The District Judge denied this claim of priority.

On appeals to the Circuit Court of Appeals both orders of the District Court were affirmed. 298 Fed. 11. Writs of certiorari were granted by this court. 266 U. S. 596.

1. These taxes were assessed against the individual partners and due from them to the United States. They were neither assessed against, nor due from, the partner-

ships. The tax assessed against Finkelstein was none the less an individual tax because the income on which it was based was derived from partnership business. The Revenue Act of 1918, 40 Stat. 1057, c. 18, § 218 (a), under which it was assessed, specifically provided that "individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." The provision that in computing the income of each partner there should be included his distributive share of the income of the partnership, whether distributed or not, did not change the nature of the tax or make it one against the partnership.

2. The Bankruptcy Act gives the United States no priority of payment out of partnership assets for a tax due from an individual partner. Section 64 (a), which provides that "the court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States . . . in advance of the payment of dividends to creditors," manifestly relates to the payment of the taxes out of the estate of the bankrupt from whom they are "due and owing." Where the bankrupt owing the tax is a member of a partnership, it gives the United States no priority of payment out of the partnership estate.

The Bankruptcy Act clearly recognizes the separate entity of the partnership for the purpose of applying the long-established rule as to the prior claim of partnership debts on partnership assets and of individual debts on individual assets, and "establishes on a firm basis the respective equities of the individual and firm creditors." *Francis* v. *McNeal,* 228 U. S. 695, 700; *Schall* v. *Camors,* 251 U. S. 239, 254. Section 5f provides that: "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any sur-

plus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership." The intention of Congress that the partnership assets shall be first applied to the satisfaction of the partnership debts, and that only the interests of the partners in the surplus remaining after the payment of partnership debts shall be applied in satisfaction of their individual debts, is plain.

It is urged, however, on the authority of *United States* v. *Herron*, 20 Wall. 251, 255, and other cases, that as the United States is not named in this section of the Bankruptcy Act it is not bound by the rule for marshalling assets thereby established. But, however this may be, it is clear that, independently of the provisions of this section, the priority of payment of taxes given the United States by § 64(a) extends only to the bankrupt's share in the surplus of the assets of a partnership of which he is a member. This follows from the decision in *United States* v. *Hack*, 8 Pet. 271, 275, a case arising under the Act of March 2, 1799,[1] providing that if the maker of any bond given to the United States for the payment of duties became insolvent or committed an act of bankruptcy, the debt due the United States on such bond should be first satisfied. The maker of such a bond had become insolvent. He had no individual property, and the assets of an insolvent partnership of which he was a member, were insufficient to pay the partnership creditors. It was held, on these facts, that the United States was not entitled to priority of satisfaction out of the partnership assets, since the Act merely gave it priority of pay-

[1] 3 Laws, U. S. 136, 197; 1 Stat. 627, 676, c. 20, § 65.

ment out of the property of its debtor, and the rule was too well settled to be questioned that his interest in the partnership property was his share in the surplus after the partnership debts were paid, and that such surplus only was liable for his separate debts. To the same effect is *United States* v. *Evans,* Crabbe, 60, 25 Fed. Cas. 1033, a case arising under the same Act. These decisions are directly applicable to § 3466 of the Revised Statutes—on which the United States relies—which incorporated the provisions of the Act of 1799 and similar Acts of August 4, 1790, and March 3, 1797, in the general provision that whenever any person indebted to the United States is insolvent, the debts due to the United States shall be first satisfied, and that this priority shall extend to cases in which an act of bankruptcy is committed. And in so far as this section, under the rule stated in *Guarantee Co.* v. *Title Guaranty Co.,* 224 U. S. 152, may now be applicable in bankruptcy proceedings, it must be held that any priority of payment to which the United States is entitled for a debt due it from an individual partner, extends only to his share in the surplus of the partnership assets.

There is no conflict between the decisions in these cases and in *Lewis* v. *United States,* 92 U. S. 618, 624, and *In re Strassburger,* 4 Woods 557, 23 Fed. Cas. 224, on which the United States relies. In the *Lewis Case* the members of the firm of Jay Cooke & Co. had been adjudicated bankrupts, and a trustee had been appointed who held their individual assets and those of the firm as well. This firm was not indebted to the United States, but another firm, of which several of the bankrupts were members, was so indebted. On these facts it was held that the bankrupt members of such other firm, as to its indebtedness, stood to the United States in the relation of "individual debtors," and that under the priority given to debts due the United States by § 3466 of the Revised

Statutes, recognized and reaffirmed in § 28 of the Bankruptcy Act of 1867, it was entitled, as a creditor of these individual bankrupts, to priority of payment out of their individual estates. There was, however, no suggestion that the United States as a creditor of these individual bankrupts was entitled to priority of satisfaction out of the partnership assets of Jay Cooke & Co. In the *Strassburger Case*, Mr. Justice Bradley, sitting at circuit, while explicitly recognizing the rule that where one member of a firm is indebted to the United States, its priority extends only to his interest in the surplus of the partnership assets, held that as the United States had a judgment against both members of the firm, it was entitled to priority of payment thereof out of their joint property in preference to their joint creditors. Whether a correct result was reached we need not inquire. And if to any extent the reasoning in this case may be in conflict with that in the *Hack Case,* it cannot be approved.

Nor is the contention of the United States strengthened by the provision in § 3186 of the Revised Statutes, as amended by the Act of March 4, 1913, c. 166, 37 Stat. 1016, that the amount due the United States from any person as a tax shall be a lien on all property and rights to property belonging to such person. To whatever extent this statute may be now applicable in a bankruptcy proceeding, under its very terms the lien includes only the property of the person owing the tax; and in the case of a partner owing an individual tax, it extends only to his interest in the surplus of the partnership property.

It results that in proceedings in bankruptcy against a partnership the partnership assets must be first applied to the payment of the partnership debts, and that the United States is not entitled to any priority of payment out of such assets for a tax due it from an individual partner, except to the extent of the share of such partner, if any, in the surplus remaining after the payment of the partnership debts.

3. The United States also relies, independently of the foregoing matters, upon the decision in *Re Brezin* (D. C.) 297 Fed. 300, 306, in which it was held that as the individual partners, instead of drawing out their distributive shares of the income of the partnership from year to year had left a large portion thereof in the partnership business, the United States had a claim in the nature of an equitable lien for the collection of their individual income taxes which it could follow into the partnership property. Whether or not this case was correctly decided on its peculiar facts, it has no application to either of the present cases, in which no such facts appear.

The decree of the Circuit Court of Appeals is

Affirmed.